In The

Supreme Court of the United States

No. 73-1671

JOE L. SMALLWOOD,

Petitioner,

v.

PEARL BREWING COMPANY, et. al.,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Joe L. Smallwood petitions for Writ of Certiorari to review the judgment of the United States Court of Appeals For The Fifth Circuit entered in the above entitled cause on February 19, 1974.

OPINIONS BELOW

The Opinion of the United States District Court for the Northern District of Texas, Dallas Division, dated March 21, 1972, is reported at CCH Fed. Sec. L. Rep. ¶ 93,434 ('71-'72 Trans. Bind). The Opinion of the United States Court of Appeals, Fifth Circuit, dated February 19, 1974, is reported at 489 F. 2d 579 (5th Cir. 1974). Since the opinions are voluminous, they are included in a separate Appendix Volume.

JURISDICTION

The District Court's jurisdiction was based on Section 27

of the Securities Exchange Act of 1934, Title 15, U.S.C. § 78aa and Title 28, U.S.C. § 1331.

The judgment of the Court of Appeals in this case was entered on February 19, 1974. The jurisdiction of this Court is invoked under Title 28, U.S.C. § 1254(1).

QUESTIONS PRESENTED

(1) Whether a discretionary waiver power permitting management to substitute a less attractive merger plan for the one approved by the shareholders without again seeking shareholder approval has such a major impact on shareholder democracy that a single mention of such power in an appendix to a proxy statement constitutes inadequate disclosure as a matter of law?

(2) Whether the Plaintiff is required to prove scienter under Rule 10b-5 and Section 14(e) of the Securities Exchange Act of 1934 in connection with material omissions in a tender offer?

(3) Whether a separate jury finding of scienter or culpability for omissions in a tender offer is required under the federal securities laws under circumstances where the Defendants directly benefit from their own misrepresentations, where they owe an extreme duty of care to the shareholders, and where the tender offer is part of a larger merger transaction?

(4) Whether the standard of scienter imposed in this case effectively frustrates the purposes of the securities laws with respect to the nondisclosure of discretionary powers?

(5) Whether scienter was in fact established in this case as a matter of law or as a result of the jury's findings?

(6) Whether the Fifth Circuit deprived Plaintiff and the members of his class of their Constitutional right to trial by jury in substituting its findings for the jury findings, for which there was substantial evidence?

(7) Whether the Fifth Circuit's interpretation of the ma-

teriality standard conflicts with the definition of materiality in *Mills v. Electric Auto-Lite*, 396 U.S. 375 (1970), and *Affiliated Ute Citizens v. United States*, 406 U. S. 128 (1972)?

(8) Whether an undisclosed promise to grant to the chief executive officer of the proxy soliciting corporation a stock option to purchase securities valued at $1,250,000.00 is material as a matter of law where such promise is conditioned upon the successful consummation of the merger?

STATUTES, RULES AND REGULATIONS INVOLVED

The statutes, rules and regulations involved are lengthy and are set forth in the separate Appendix Volume. The provisions involved are: Section 14(a), 15 U.S.C.A. Section 78n(a); Section 10(b), 15 U.S.C.A. Section 78j(b); Section 14(e), 15 U.S.C.A. Section 78n(e); Rule 14a-5, 17 C.F.R. § 240.14a-5; Rule 14a-9, 17 C.F.R. § 240.14a-9; Rule 10b-5, 17 C.F.R. 10b-5; Schedule 14A Item 4; Schedule 14A Item 7(d), Instructions. The Seventh Amendment to the United States Constitution is also invoked.

STATEMENT OF THE CASE

On February 5, 1970, Joe Smallwood, a former shareholder in Pearl Brewing Company, brought this suit individually, derivatively, and as a representative of a class of former Pearl shareholders, against Pearl Brewing Company (the nominal Defendant but beneficial Plaintiff), Southdown, Inc., Zapata Norness, Inc., Albert J. Range and D. Doyle Mize, alleging numerous violations of the Securities Exchange Act of 1934 in connection with the December 30, 1969, merger of Pearl Brewing Company into Southdown, Inc. and in connection with a related tender offer on November 18, 1969, for securities of Southdown, Inc.

Under the Pearl-Southdown merger proposal, an essential pre-condition to the merger was a promise by Southdown (the acquiring Company) to obtain a firm commitment from a group of underwriters to purchase for a period of ten days following

the merger at a price of $45 per share up to 45% of the new Southdown preferred stock to be issued in the merger to the Pearl shareholders. Pearl management deemed the underwriting commitment essential to make the Southdown offer competitive with the $45 per share competing merger offer made by Aztec Oil and Gas Company (and preferred by Pearl's own investment analysts), and refused to even submit an offer to the Pearl shareholders of less than $45 per share. However, after the Pearl shareholders' approved this merger plan in September, 1969, and after the shareholders had been sent tender offer materials in November, 1969, imposing a cut-off date of December 2, 1969, for tenders to the underwriters, the Pearl Board on December 22, 1969, passed a resolution invoking a waiver power (mention of which was buried in the second appendix to the proxy statement) that permitted the Board to waive the underwriting commitment and the ten-day period for tenders, in writing, and to consummate the merger without further shareholder approval.[1]

On December 30, 1969, the merger was consummated without the underwriting commitment or the ten days after the merger for tenders. However, those shareholders who had tendered their Pearl stock prior to December 2, 1969, received $45 per share in the merger.[2] The remaining Pearl shareholders owning 82% of the outstanding Pearl stock received Southdown stock in the merger worth only $37.80 per share. The suit alleged that both the proxy materials and the related tender offer were materially false and misleading.

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[1]The resolution that was passed failed to mention the ten-day period for tenders and no written waiver of this right ever occurred.

[2]Although the tender offer was for Southdown stock, the tender offer materials instructed the Pearl shareholders to tender shares of *Pearl* stock to an escrow agent to be held until they were converted in the merger to Southdown stock. After the merger, the Southdown stock was picked up and paid for by Zapata Norness, Inc., the parent and control person of Southdown. This procedure for a pre-merger tender of Pearl instead of *Southdown* stock was never mentioned in the proxy materials.

On January 28, 1972, following trial of the case and denial of Plaintiff's motion for a directed verdict, the case was submitted to a jury on special interrogatories.[3] The jury found *inter alia* that the November 18, 1969, tender offer materials were materially false and misleading for failure to inform the Pearl shareholders that the December 2, 1969, deadline for tenders was a change in the terms of the agreement and plan of merger; for failure to disclose that the merger of Pearl into Southdown could be consummated without an underwriting commitment and without a period of ten days following the merger in which the former Pearl shareholders could tender their Southdown stock; and for failure to disclose that a corporation with a substantial investment in Southdown, i.e., Zapata, could be substituted for the underwriter as the purchaser of the tendered shares, all of which the jury found operated as a fraud or deceit upon the Pearl shareholders in connection with the merger. The jury also found that if the material omissions in the tender offer materials had been disclosed as required by law, a reasonable Pearl shareholder would have tendered his Southdown shares for $45 per share. Since the nontendering shareholders received Southdown stock in the merger which the jury found to be worth only $37.80 per share, each of these nontendering shareholders suffered a loss of $7.20 per share as a direct result of the misleading tender offer materials. The jury also found that elimination of the ten-day period after the merger for tenders was a material change in the merger plan; that the power of the Pearl directors to waive the condition of a firm underwriting commitment was not inadequately disclosed in the Pearl proxy statement; and that a secret stock option of 25,000 shares of Southdown stock valued at approximately $1,250,000.00 was in fact agreed to be given by the chief executive officer of Southdown, Inc. (Defendant Mize) and accepted by the chief executive officer

[3]The jury's answers to the special interrogatories (special issues) are reproduced in the separate Appendix Volume.

of Pearl (Defendant Range), that it was not adequately disclosed in the Pearl proxy statement, but that it was not material.

Following return of the jury verdict, Plaintiff filed motions for judgment on the verdict and notwithstanding the verdict. On March 21, 1972, the District Court filed a memorandum opinion and judgment denying any recovery to Plaintiff either on the verdict or notwithstanding the verdict. *Smallwood v. Southdown, Inc., et al,* CCH Fed. Sec. L. Rep. ¶ 93,435 (N.D. Tex. 1972) ('71-'72 Trans. Bind).

On appeal, the Fifth Circuit affirmed the District Court, but gave different reasons for its decision. The Court of Appeals rejected the District Court's legal conclusion that Section 14(e) of the Williams Act, 28 U.S.C. § 78n(e), applies only to "takeover bids," 489 F. 2d at 597-599; it rejected the District Court's conclusion that disclosure of the waiver power in the proxy materials obviated any necessity for disclosure of that power in the tender offer materials, 489 F. 2d at 605-606, and it rejected Defendants' arguments that the November 18, 1969, letter and related materials was not a "tender offer" within the meaning of the Williams Act, 489 F. 2d at 599. However, the Court of Appeals denied Plaintiff any recovery on the jury findings concerning the false and misleading tender offer materials on the grounds that the Plaintiff had not obtained a separate jury finding on scienter or culpability, a ground not considered by the District Court. The Court of Appeals also held (contrary to the jury's findings) that no ten-day period for tenders after the merger had been promised the Pearl shareholders. 489 F. 2d at 608. Furthermore, the Court upheld the jury finding that the waiver power was not inadequately disclosed in the proxy statement; upheld the finding that the undisclosed $1,250,000.00 stock option was not material; and rejected the argument that the standard of materiality used by the District Court in charging the jury conflicted with two recent Supreme Court decisions.

REASONS FOR GRANTING THE WRIT

First Question Presented:

DOES A DISCRETIONARY WAIVER POWER WHICH PERMITS SUBSTANTIAL ALTERATIONS IN A MERGER PLAN WITHOUT FURTHER SHAREHOLDER APPROVAL HAVE SUCH A MAJOR IMPACT ON SHAREHOLDER DEMOCRACY THAT DISCLOSURE ONLY IN AN APPENDIX TO THE PROXY STATEMENT CONSTITUTES INADEQUATE DISCLOSURE AS A MATTER OF LAW?

On August 12, 1969, in the wake of a false and omissive letter and press release,[4] management sent out a 104-page proxy statement to the Pearl shareholders. The proxy statement described the underwriting commitment four more times in the first 20 pages, specifically at pages 5, 13, 21, and 23 (Ex. Vol. 11, 19, 21, and 29), and the ten-day tender period at pages 5 and 13 (Ex. Vol. 11 and 19). At none of these points was any mention made of the power to waive the underwriting commitment or the ten-day period for tenders. The "SUMMARY DESCRIPTION OF THE SOUTHDOWN-PEARL MERGER" described the underwriting commitment and the ten-day tender period, but not the waiver power. Moreover, several of the other references to the underwriting commitment appeared directly under bold face captions. One read: "CONDITIONS TO THE CONSUMMATION OF THE MERGER" (p. 13, Ex. Vol. at 19). Another read: "ASSUMING THE MERGER OF SOUTHDOWN AND PEARL" (p. 21, Ex. Vol. at 27). Nothing was said under any of these captions of the possibility that Pearl might be merged into Southdown without an underwriting commitment or without a tender period of ten days after the merger, and nothing was said of such a possibility in the entire narrative portion of the proxy statement.

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[4]The press release described the underwriting commitment, but omitted any reference to the waiver power.

The only mention of a waiver power in the entire proxy material were six words appearing in parenthesis at approximately page 85 of the proxy materials in a legal document entitled the "Agreement and Plan of Merger." This Agreement was appended to the proxy statement as Appendix II and contained the words: "(Or waiver by Pearl in writing)." The underwriting condition was listed in subparagraph (c) underneath this language on the following page. These six words constitute the sole source of Defendants' alleged power to waive the underwriting commitment and the *only* disclosure of this vital discretionary authority in the entire proxy statement.

In terms of placement in the proxy materials and equality of emphasis with the underwriting commitment, there is no doubt that the waiver power was inadequately disclosed. The Court of Appeals admitted as much, saying:

> "There is no dispute that both by position in the proxy materials and by weight of repetition Southdown's obligation to obtain an underwriting commitment gained prominence over the power to waive that provision. And the general references to the merger agreement did not completely counter-balance this effect." 489 F. 2d at 602.

Nonetheless, the Court refused to find inadequate disclosure as a matter of law as numerous other courts have done in similar circumstances.[5] The Court conceded that "The position and emphasis given in a proxy statement to waiver powers invoked for any cause reasonably to be anticipated at the time a proxy statement is distributed deserves close judicial scrutiny," *Id.*, but did not think the evidence showed that at the time the proxy materials were sent out it was apparent that the waiver power would have to be invoked. On this basis, the Court found that the equal emphasis cases were inapplicable. 489 F. 2d at 603.

The Court's focus on the foreseeability of the underlying event or "cause" for invoking a waiver power is an improper

[5]See *Mills v. Electric Auto-Lite*, 403 F. 2d 429 (7th Cir. 1968), rev'd. on other grounds, 396 U.S. 375 (1970); *Swanson v. American Consumer Industries*, 415 F. 2d 1326 (7th Cir. 1969); *Beatty v. Bright*, 318 F. Supp. 169 (S.D. Iowa 1970); *Gould v. American Hawaiian Steamship Co.*, 331 F. Supp. 981, 995 (D. Del. 1971); *Kohn v. American Metal Climax, Inc.*, 322 F. Supp. 1331, 1362 (E. D. Pa. 1970), modified on other grounds, 458 F. 2d 255, 265 (3rd Cir. 1971), cert. denied, 409 U.S. 874 (1971).

approach to the disclosure of discretionary authority. The whole purpose of discretionary powers is to provide for future events that might occur, but which cannot be certain to occur. The existence of the power is the fact requiring disclosure, not the likelihood of its exercise. If the proxy solicitors are sufficiently prescient to include the power to waive in the merger agreement, it is not asking too much to require them to include the power in the proxy statement. To require Plaintiff to demonstrate a probability that the power would be exercised is to impose a standard calculated to minimize, if not entirely to eliminate, any obligation on management to make full disclosure of discretionary powers under the securities laws. The shareholders are entitled to know of the power to waive, so that they can speculate along with management as to the likelihood of its exercise.

The Fifth Circuit's approach also misapprehends the real dangers inherent in the grant of discretionary powers by shareholders to management. A discretionary power such as was claimed to exist in this case vests in management the authority to entirely restructure a transaction after it has received shareholder approval and to bind the shareholders to that restructured transaction without again seeking their consent. *As such, discretionary powers strike at the very heart of the proxy soliciting process.* Unless shareholders are made aware that approval of a transaction containing a discretionary power means in effect approval of *two* transactions, i.e., approval of the transaction in both its *altered* and its *unaltered* form, the rest of the disclosures in the proxy statement will only serve to further mislead them by describing in great detail a transaction which may never take place. There is consequently (as was pointed out to the Court of Appeals) a great potential for fraud inherent in this process. We reiterate that under this procedure, "management can come to the shareholders for approval of an offer that has certain irresistible features, obtain approval largely on the basis of those features, and then eliminate them by

use of the blank check or waiver power the shareholders have given them." 489 F. 2d at 603. This danger makes the necessity for a parity of emphasis between the terms and conditions subject to waiver and the waiver power itself, greater and not lesser, as the Court of Appeals determined.

The Court's treatment of the disclosure question is also in error in failing to consider whether a single isolated mention of "waiver" in the second appendix to the proxy statement was "adequate" for the purpose of apprising the shareholders that a waiver power was in fact being solicited.[6] By focusing on the foreseeability of the event that triggers the need to use the discretionary power, rather than the manner in which the power itself was disclosed, the Court of Appeals has effectively denied the shareholders an informed choice as to whether or not to give management any discretionary powers at all. Such a ruling greatly diminishes the effective exercise of the corporate franchise which this Court has sought to protect in *J. I. Case Company v. Borak*, 377 U.S. 426 (1964), and *Mills v. Electric Auto-Lite*, 396 U.S. 375 (1970); and radically reallocates power and decision-making between the shareholders and management. Moveover, the Court's ruling directly contradicts the S.E.C.'s own regulations regarding the proper disclosure of discretionary authority since no declaration was contained in the proxy statement indicating the issuers' present intentions with respect to the exercise of the waiver power, or the circumstances rendering such information unavailable. See Rule 14a-5. Had such information been furnished, at least the shareholders would have had some *warning* that a waiver power was being solicited from them.[7]

[6]As this Court said in *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 201 (1963): ". . . what is required is 'a picture not simply of the show window, but of the entire store . . . not simply truth in the statements volunteered, but disclosure'."

[7]As this Court stated in the *Mills* case:

> "An *adequate* disclosure of this relationship would have *warned* the stockholders to give more careful scrutiny to the terms of the merger than they might to one recommended by an entirely disinterested board." (Emphasis added), 396 U.S. at 384, n.6.

Finally, the Court of Appeals erred in utterly failing to consider the impact of the July 17, 1969, letter and press release on the adequacy or inadequacy of disclosure in the August 12, 1969, proxy materials. Though acknowledging that pre-proxy communications must be closely regulated since "seeds of argument could be planted so deeply and securely prior to the time of formal proxy solicitation as to resist effectively later uprooting," 489 F. 2d at 600, the Court did not even try to show that the effects of this false and omissive communication were ever dissipated or "uprooted" by Defendants' affirmative acts. Yet, Defendants were under a continuing obligation to correct the misleading omission in this press release by calling its defects to the attention of the shareholders.[8] Since a disclosure which is necessary to *correct* a prior communication must be more complete than one that carries no such burden of rectification, the bare mention of the waiver power in the appendix to the proxy statement was inadequate disclosure as a matter of law.

Under all the circumstances, the Court should grant the Writ to deal with a proxy soliciting technique that threatens to undermine the disclosure purposes of the proxy rules, to establish that the "equal emphasis" rule is applicable to the grant of discretionary powers, and to reaffirm the legal requirement of "adequate" disclosure.

Second Question Presented:

DOES SCIENTER HAVE TO BE PROVEN UNDER RULE 10b-5 AND SECTION 14(e) OF THE SECURITIES EXCHANGE ACT OF 1934, AND IF SO, WHO HAS THE BURDEN OF PROVING IT?

The Circuits are badly split on whether any scienter or

[8]See *SEC v. Great American Industries, Inc.*, 407 F. 2d 453, 461 (2nd Cir.1968), cert. den., 395 U.S. 920; *SEC v. Shattuck Denn Mining Corp.*, 297 F. Supp. 470, 476 (S.D.N.Y. 1968); *Cochran v. Channing Corp.*, 211 F. Supp. 239, 243 (S.D.N.Y. 1962); Fuerstein, "The Corporation Obligations of Disclosure Under the Securities Laws When It Is Not Trading In Its Stock," 15 *New York Law Forum*, 385, 395-396 (1969). See also, Rule 14a-9; *Central Foundry Co. v. Gondelman*, 166 F. Supp. 429, 447-448 (S.D.N.Y. 1958).

culpability requirement exists under Rule 10b-5, and if so, whose burden it is to prove it. As the Court in this case acknowledged, four Circuits have stated or implied that there is no scienter or culpability requirement under Rule 10b-5.[9] Recently, the Tenth Circuit held that it will not wholly abandon scienter, but will impose liability under Rule 10b-5 unless "The party responsible for the misrepresentation or omission sustains the burden of proving that he did not know, and in the exercise of reasonable care could not have known that it was a misrepresentation or omission."[10] Moreover, the Second Circuit which traditionally has required scienter in 10b-5 cases,[11] has abandoned the requirement in proxy cases under Section 14a and Rule 14a-9.[12]

Quite recently, the Ninth Circuit has promulgated a flexible duty standard or variable scienter test. See *White v. Abrams*, CCH Fed. Sec. L. Rep. ¶ 94,457 (9th Cir. 1974) (Current Volume). Under this view, the facts of the particular case will determine whether or not scienter is required. Where a fiduciary relationship exists between the parties, as it did in this case, and where all the facts are in the possession of the Defendants, as they were here, the Court holds that proof of material nondisclosures, causation and damages is sufficient for liability. CCH Fed. Sec. L. Rep. ¶ 94,457 at p. 95,610.

The Circuits are also divided on whether or not scienter must be shown under Section 14(e) of the Securities Exchange Act of 1934 which is applicable to tender offers. The Second Circuit in *Chris-Craft Industries, Inc. v. Bangor Punta*, 480 F. 2d 341, 363 (2nd Cir. 1973), has held, like the Fifth Circuit

[9] 489 F. 2d at 606 and 606, n.33. See, e.g., *Ellis v. Carter*, 291 F. 2d 270 (9th Cir. 1961); *Kohler v. Kohler*, 319 F. 2d 634, 637 (7th Cir. 1963); *Myzel v. Fields*, 386 F. 2d 718 (8th Cir. 1967); *Stevens v. Vowell*, 343 F. 2d 374 (10th Cir. 1965).

[10] *Mitchell v. Texas Gulf Sulphur*, 446 F. 2d 90, 102 (10th Cir. 1971).

[11] *Lanza v. Drexel & Co.*, 479 F. 2d 1277, 1304-1306 (2nd Cir. 1973) (en banc); *Cohen v. Franchard Corporation*, 478 F. 2d 115, 122-124 (2nd Cir. 1973).

[12] See, *Gerstle v. Gamble Scogmo*, 478 F. 2d 1281, 1298-1301 (2nd Cir. 1973).

in this case, that "some form of scienter" must be shown under Section 14(e). However, the Ninth Circuit has reached a contrary conclusion and has directly criticized the Second Circuit's decision. *White v. Abrams,* CCH Fed. Sec. L. Rep. ¶ 94,457 at p. 95,607 (Current Volume), (9th Cir. 1974).[13]

The conflict in decisions among the Courts of Appeals as to whether or not a scienter requirement even exists under the federal securities laws, if so, under which sections it exists, and which party must bear the burden of proving it, creates a clear and present need for action by this Court if predictability and uniformity of decision making is not to be lost under the securities laws. This is especially true of actions arising under Section 14(e) (the Williams Act) of the Securities Exchange Act of 1934 (which this Court has never had occasion to interpret) since the statutory basis for requiring any form of scienter under this statute is highly questionable.[14]

We submit that this Court's examination of the statutory and logical basis for imposing a scienter requirement under § 14(e) is necessary to prevent frustration of the Congressional

[13]"We believe it unfortunate that the Second Circuit attempted to limit this duty by requiring some degree of scienter or culpability and holding that mere negligent conduct would not be sufficient for liability. The exact standard that the court would apply, however, is not clear to us."

[14]See A. Bromberg, *Securities Law: Fraud,* § 8.4(440), p. 204.78-204.79 (1973).

The conclusion that scienter is required under § 14(e) is premised on the observation that "the underlying proscription of Section 14(e) is virtually identical to that of Rule 10b-5." *Chris-Craft Industries, Inc. v. Piper Aircraft Corp.,* supra, 480 F. 2d at 362. Most courts have thought it necessary to require scienter under Rule 10b-5 because of the belief that liability based simply on the use of materially "false and omissive statements," as apparently contemplated by the language of subsection (2) of the Rule, would cause the Rule to exceed the Commission's authority under Section 10(b) to regulate "manipulative or deceptive devices." See, *SEC v. Texas Gulf Sulphur Co.,* 401 F. 2d 833, 868 (2nd Cir. 1968); and *Gerstle v. Gamble Scogmo,* supra, 478 F. 2d at 1299. However, this rationale can have no application to § 14(e) which, like § 14(a), is a legislative enactment in its own right. The Fifth Circuit's conclusion that Congress in enacting Section 14(e) adopted "the precedential baggage" of Rule 10b-5 is

purpose, and that this case, with its extensive jury findings of material omissions in the tender offer materials (Issues 15, 16 and 17) and findings of fraud and deceit in connection with the merger (Issues 19(b), (c), (d), and (f)) make this an ideal case and occasion for examination of the scienter requirement.

Third Question Presented:

WAS A SEPARATE JURY FINDING OF SCIENTER REQUIRED IN THE CIRCUMSTANCES OF THIS CASE?

In requiring scienter to be separately proved in this case, the Fifth Circuit ignored the limitations on the scienter requirement which have been recognized under the common law of fraud. Even at common law, no scienter requirement exists in an action for fraud or misrepresentation where the Defendant has a pecuniary interest in the transaction and benefits from his own misrepresentations. See, *Gerstle v. Gamble Scogmo, Inc.*, supra, 478 F. 2d at 1300; Keeton, "Fraud: The Necessity For An Intent To Deceive," 5 *U.C.L.A. Law Review*, 583, 600-02 (1958). Since the jury found that a reasonable shareholder would have tendered his stock but for the false and omissive tender offer materials (issue 18), Southdown and Zapata, in fraudulently discouraging tenders, were able to acquire Pearl Brewing Company for a lesser price than they otherwise would have, and thereby became the direct beneficiaries of their own fraud. To require scienter under these circumstances is to require a higher standard of culpability under Rule 10b-5 and Section 14(e) than is even required by the common law of fraud.

Secondly, under the flexible duty standard adopted by the

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f.n. 14 (continued)
therefore highly suspect. 489 F. 2d at 605. The more logical inference is that Congress intended to do away with the limitation that had arisen under Rule 10b-5 by placing the proscriptions against "false and omissive statements" in a legislative enactment that would not suffer the infirmities of the Rule. Furthermore, we would like to know, in view of the conflict among the Circuits, just what the "precedential baggage" of Rule 10b-5 really is!

Court in *White v. Abrams*, supra, the Defendants in this case owed an extremely high duty of care to the stockholders. As between the wholly innocent shareholders and the responsible fiduciaries, the loss, if any, should fall on the latter.

Finally, the Court's ruling has particularly oppressive results in the context of this case since the tender offer grew out of and was in fulfillment of a promise made to the shareholders in proxy materials. Since negligence alone is a sufficient basis for liability where material omissions occur in proxy materials,[15] it should also be a sufficient basis for material omissions in tender offer materials which are an *integral part* of the same merger plan. There should not be a bifurcation of the standards governing § 14(a) and § 14(e) of the securities laws where the tender offer is an essential part of a larger merger transaction, and the misrepresentations in the tender offer operate as a breach of the promises made to the shareholders in procuring their assent to the merger. As this Court stated in *Mills v. Electric Auto-Lite*, 396 U.S. 375 (1970):

> "Where the defect in the proxy solicitation relates to *the specific terms of the merger*, the district court might appropriately order an accounting *to ensure that the shareholders receive the value that was represented as coming to them.*" (Emphasis added), 396 U.S. at 388.

The scienter holding of the Court of Appeals in this case effectively thwarts the above stated policy of the *Mills* case, for it allows a shareholder to be specifically promised something in return for his proxy (in this case a tender offer) and then when the promise is not fulfilled (e.g., the tender offer that is subsequently made is false and omissive), to judge that false and omissive tender offer by a far more permissive standard than would be tolerated in the proxy materials themselves.

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[15] *Gerstle v. Gamble Scogmo, Inc.*, 478 F. 2d 1281, 1298-1300 (2nd Cir. 1973); *Gould v. American Hawaiian Steamship Company*, 351 F. Supp. 853, 864 (D. Del. 1972); *Berman v. Thompson*, 312 F. Supp. 1031, 1035 (N.D. Ill. 1970); *Norte & Co. v. Huffines*, 304 F. Supp. 1096 (S.D.N.Y. 1968), aff'd. in pertinent part, 416 F. 2d 1189 (2nd Cir. 1969).

This Court should act to prevent the frustration of the underlying policies and purposes of the securities laws and should grant the Writ on the scienter question as it did on a comparable issue under the Investment Advisers Act of 1940. See *S.E.C. v. Capital Gains Research Bureau,* supra.

Fourth Question Presented:

DOES THE STANDARD OF SCIENTER IMPOSED IN THIS CASE EFFECTIVELY FRUSTRATE THE PURPOSES OF THE SECURITIES LAWS WITH RESPECT TO THE NONDISCLOSURE OF DISCRETIONARY POWERS?

The Fifth Circuit purported to follow the lead of the Second Circuit in *Chris-Craft Industries, Inc. v. Bangor Punta,* 480 F. 2d 341 (2nd Cir. 1973), in imposing a scienter requirement in connection with the tender offer in this case. However, the two decisions are in fact in direct conflict with one another.

The *Chris-Craft* case involved, among other things, a letter that had been sent out by the Piper family to the shareholders of Piper Aircraft Corporaiton in opposition to the tender offer of Chris-Craft. This letter was subject to the provisions of Section 14(e), and the Second Circuit, reversing the District Court, found a material omission in violation of the statute based on the Piper family's failure to reveal in their shareholder letter that Piper's agreement with Grumman (pursuant to which Grumman had agreed to buy 300,000 shares of Piper stock at $65 per share) was subject to a "put" which allowed Grumman to return the Piper stock after six months and receive a full refund of the purchase price. The Court held that the failure to reveal this "put" gave a false impression that a Grumman-Piper merger was imminent when in fact the stock purchase agreement was only a preliminary and conditional overture directed toward a possible merger. The Court held the Piper family liable under Section 14(e) for the misleading tender letter pursuant to the following standard of scienter:

> "In sum, and put as simply as possible, the standard for determining liability under § 14(e) on the part of a person making a misleading tender offer, or a responsible officer of a corporation making such an offer, is whether plaintiff has established that defendant either (1) *knew the material facts that were misstated or omitted*, or (2) failed or refused to ascertain such facts when they were available to him or could have been discovered by him with reasonable effort." (Emphasis added.) 480 F. 2d at 364.

Since there was no doubt that the Piper family knew of the "put" with Grumman, their liability under this standard for failure to disclose the "put" followed as a matter of law.

The contrary result on very similar facts in the instant case can only be explained by a complete distortion of the scienter requirement. Instead of focusing on whether the Defendants knew or should have known of the power to consummate the merger without the fulfillment of the pre-merger conditions, which they obviously did, the Court determined that scienter had not been shown because the possibility that an underwriting commitment could not be obtained did not "loom so large" at the time the tender offer materials were sent out that the Defendants had to be deemed "more than negligen[t]" in not disclosing that the merger could be consummated without the underwriting and without the ten-day period for tenders ("the potential consequences"). As the Court stated:

> "There was of course a possibility, recognized at least by Albert Range, that the price of Southdown common would sink to the point where an underwriting could not be obtained. *But we do not view the evidence as establishing that this possibility loomed so large that the failure to indicate in the November 18 letter the potential consequences should an underwriting not take place was, as a matter of law, more than negligence.*" (Emphasis added), 489 F. 2d at 609.

This statement wholly misconceives the scienter issue, if any, in the case. The fact which had to be known to the De-

fendants was the existence of the power to consummate the merger without the underwriting commitment or the ten-day period, and *not* the likelihood or unlikelihood of obtaining an underwriting commitment; just as the undisclosed fact in the *Chris-Craft* case which had to be known to the Defendants was the existence of the "put," and not the likelihood or unlikelihood that Grumman would ever exercise it. The "power" like the "put" was a present and existing fact which could have been disclosed in the tender materials because it *was* known to the Defendants. Its mere existence, whether exercised or not, had a great effect on a shareholder's attitude toward the tender offer,[16] i.e., it was "material" as found by the jury. (Issues 15 and 16). The fact that Plaintiff herein did not show

[16]Disclosure of the waiver power in the tender offer and the possibility that the merger might occur without an underwriting was essential if a shareholder was to make an intelligent decision on whether to tender his stock. This was so because the tender letter was entirely cast in the format of a tender to an underwriter (Ex. Vol. 109-111), and the attachments thereto imposed a "stand-off" agreement upon tendering shareholders (not disclosed in the proxy statement) (R. 1189-v - 1192) which prohibited a tendering shareholder from selling for a period of 90 days after the merger, any Southdown stock not purchased by the underwriters (Ex. Vol. 113 at 115). This provision was for the benefit of the underwriters who intended to resell the Southdown stock and did not want competition during their selling efforts from the 55% of the Southdown stock that would still be in the hands of the Pearl shareholders after the merger. So long as the underwriter was going to be the purchaser of the securities, as the tender letter affirmatively lead a reasonable shareholder to believe he would be, there was good reason for a shareholder *not* to tender his stock so as to remain free to sell 100% of his stock on the open market after the merger. A shareholder who refrained from tendering was free to compete with the underwriter in the open market after the merger and ride his coattails. However, none of this occurred because the condition of the underwriting was waived, Zapata was substituted for the underwriter, and the stand-off provision was removed. By then, however, the deadline for tenders had long passed, and those who had justifiably refrained from tendering their stock in the belief that it was not advantageous to tender to an underwriter wound up on the merger with a stock worth $37.80 instead of $45.00 in cash. The jury was justified in believing that under these circumstances, failure to disclose ~~that~~ in the tender offer materials the merger could be consummated without an underwriting agreement was a material omission, despite any prior disclosure in the proxy materials.

that the Defendants knew when they mailed the tender materials that the underwriting could not be obtained (and therefore that the waiver power would have to be utilized if the merger was to take place) can no more excuse the failure to disclose a present and existing waiver power than could the failure to prove in *Chris-Craft* that Grumman was going to exercise its "put." The "power" like the "put" was known to the Defendants. This should have been sufficient. To also require the Plaintiff to prove Defendants' knowledge of the imminence of the event which will necessitate use of that power is tantamount to requiring the Plaintiff to shoulder the impossible burden of proving present knowledge of a future event.[17]

Furthermore, to say, as the Fifth Circuit has done, that the power to consummate the merger without fulfilling the merger conditions need not be disclosed because the occasion to exercise the power did not "loom large" at the time the tender offer materials were sent out is to confuse scienter with materiality. The likelihood that an event will occur in the future is an element of materiality, not of scienter, and relates only to future events, not to existing powers. As the Court stated in *S.E.C. v. Texas Gulf Sulphur Co.*, 401 F. 2d 833, 849 (2nd Cir. 1968):

> "[W]hether facts are material . . . when the facts relate to a particular event . . . will depend at any given time upon a balancing of both the indicated *probability that the event will occur* and the anticipated magnitude of the event in light of the totality of the company activity." (Emphasis added.)

The Fifth Circuit's erroneous incorporation of a foreseeability issue into the scienter standard in this case not only imposed the impossible burden on Plaintiff of proving present knowledge of a future event; it afforded the Circuit Court with an otherwise prohibited opportunity to overrule, *sub silentio*, the jury's findings on materiality. (Issues 15, 16 and 17). That

[17]Thus, had the Second Circuit required Plaintiffs in *Chris-Craft* to prove that Grumman intended to exercise its "put" when the Piper letter was sent, the Plaintiffs could not have prevailed.

was clear error. The Fifth Circuit's verbal sleight of hand should not be allowed to serve as an instrument for substituting its judgment for the jury's.

The Writ should be granted to prevent the total frustration of the purposes of the securities laws in respect of their application to the disclosure of discretionary powers.

Fifth Question Presented:

WAS SCIENTER IN FACT ESTABLISHED IN THIS CASE AS MATTER OF LAW OR AS A RESULT OF THE JURY'S FINDINGS?

The Fifth Circuit held in this case that since no separate issue on "culpability" was submitted to the jury, the issue is deemed found against Plaintiff in accordance with the District Court Judgment. Rule 49(a), F.R. Civ. P. However, since the material facts omitted from the tender offer materials were the power to consummate the merger without an underwriting commitment and without a ten-day period for tenders, and since these facts were part and parcel of the July 14, 1969, merger agreement, and (according to the Court) were disclosed to the shareholders in the August, 1969, proxy materials,[18] they were obviously facts that were known or should have been known to Defendants in November of 1969 at the time the tender offer materials were sent out. Defendants' knowledge of the omitted facts was therefore not a disputed issue upon which any jury finding was required. See, *Johns Hopkins University v. Hutton*, 326 F. Supp. 250, 256-257 (D.Md. 1971), aff'd., 499 F. 2d 912, 914 (1973). Moreover, the jury expressly found that the failure to inform the shareholders that the merger could be consummated without an underwriting commitment and without a ten-day period for tenders, and the failure to inform them that a party with a substantial financial interest in Southdown could be substituted for the underwriter, each constituted an "act, practice, or course of business which op-

[18] 489 F. 2d at 601.

erated as a *fraud* or *deceit* upon the Pearl shareholders in connection with the Pearl-Southdown merger." (Emphasis added) (Issues 19(c), (d), and (f)). These findings precisely track the language of subsection 3 of Rule 10b-5 which this Court applied in similar circumstances in *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972).[19] Since these findings track the language of the Rule, a separate and further finding of scienter should not have been required.

The Writ should be granted to rectify a clear misapplication of Rule 49(a), F.R. Civ. P. and frustration of this Court's decision in the *Ute* case.

Sixth Question Presented:

DID THE FIFTH CIRCUIT'S CONCLUSION THAT THE PEARL SHAREHOLDERS WERE NEVER PROMISED A TEN-DAY PERIOD AFTER THE MERGER FOR TENDERING THEIR STOCK DEPRIVE PLAINTIFF AND THE MEMBERS OF HIS CLASS OF THEIR CONSTITUTIONAL RIGHT TO TRIAL BY JURY?

The Fifth Circuit concluded that no promise was ever made to the Pearl shareholders giving them a period of ten days after the merger in which to tender their stock. 489 F. 2d at 607 and 608. Yet, there are at least six jury findings directly contrary to this de novo fact finding by the Court of Appeals

[19]In the *Ute* case, this Court stated through Mr. Justice Blackmun:

> "The defendants may not stand mute while they facilitate the mixed-bloods' sales to those seeking to profit in the non-Indian market the defendants had developed and encouraged and with which they were fully familiar. *The sellers had the right to know that the defendants were in a position to gain financially from their sales and that their shares were selling for a higher price in that market.*" (Emphasis added), 406 U.S. at 153.

The jury in this case found that it was the omission of a material fact and a fraud and deceit upon the Pearl shareholders not to inform them that a party with a substantial financial interest in Southdown could be substituted for the underwriter (Issues 17 and 19(f)). Indeed, not only was Zapata's financial self-interest in the merger withheld from the shareholders whose tenders were solicited, its very identity as purchaser was unknown to them. The Fifth Circuit's refusal to give effect to these jury findings flies in the face of this Court's ruling in the *Ute* case.

(Issues Nos. 1, 2, 15, 16, 17(b), 19(d)), and the Court of Appeals did not even try to show that the evidence supporting these findings was such that reasonable minds could not have reached such a conclusion. *Boeing Company v. Shipman*, 411 F. 2d 365, 374 (5th Cir. 1969) (en banc). Even the District Court agreed that the Pearl shareholders *might* have interpreted the proxy materials as giving them a period of ten days after the merger in which to tender their stock, CCH Fed. Sec. L. Rep. supra, at p. 92,156.

The proxy materials themselves clearly support the jury findings. They provided:

> "Consummation of the merger is subject to several conditions specified in the Pearl Agreement . . . one of the conditions to Pearl's obligation to consummate is the receipt by Southdown of a firm commitment from a group of underwriters to purchase for *a period of ten days following the effective date of the merger*, at a price of $45 net per share, up to 45% of the Southdown Preferred Stock into which the Pearl stock will have been converted. Such a commitment would contemplate that in the event more than 45% of the *Southdown Preferred Stock was tendered to the underwriters within the specified period*, shares would be accepted *from all tendering stockholders* on a pro rata basis." (Emphasis added) (Ex. Vol. at 11).

The *only* "specified period" referred to in the entire paragraph is the "period of ten days following the effective date of the merger." Moreover, since no "Southdown Preferred Stock" was outstanding prior to the merger, none could be "tendered" prior to the merger. The requirement of tendering *Pearl* stock in advance of the merger originated in the tender offer materials and was nowhere disclosed in the proxy materials.

Under the circumstances, the Fifth Circuit's summary reversal of the jury's findings concerning the ten-day period for tenders is absolutely without basis in law and deprives Plaintiff and more than 3,000 members of his class of their constitutional right to trial by jury under the Seventh Amendment to the United States Constitution.

Seventh Question Presented:

DID THE FIFTH CIRCUIT'S INTERPRETATION OF THE MATERIALITY STANDARD CONFLICT WITH THIS COURT'S DEFINITION OF MATERIALITY IN *MILLS V. ELECTRIC AUTO-LITE*, 396 U.S. 375 (1970), AND *AFFILIATED UTE CITIZENS V. UNITED STATES*, 406 U.S. 128 (1972)?

The District Court in the Charge to the jury defined "material" as something to which a reasonably prudent person *"would* attach importance in determining his course of action." (See Jury Charge in Appendix Volume) Plaintiff excepted to this instruction on the basis that the proper definition of "material" is something which a reasonable shareholder *might* consider important in determining how to vote. The District Court's instruction is clearly in error.[20] A nondisclosure is material if it has a "significant *propensity* to affect the voting process." *Mills v. Electric Auto-Lite Co.*, 396 U.S. at 384 (emphasis in text). The term "would" implies a certainty of affecting the voting process, not a "significant propensity" to affect it. The District Court's instruction therefore substantially increased the Plaintiff's burden of proof beyond that required by applicable legal requirements.

The Court of Appeals acknowledged that this Court had used the word "might" in both the *Mills* case and the *Ute* case in discussing the materiality of the omissions and misrepresentations involved in those cases. However, the Court concluded that:

> "There is no evidence of any desire by the Court [the Supreme Court] to replace the traditional standard with a more relaxed one . . . .Moreover, the word 'might' does not seem to have been carefully considered by the Court." 489 F. 2d at 604.

Accord: *Gerstle v. Gamble Scogmo, Inc.*, 478 F. 2d 1281, 1301-1302 (2nd Cir. 1973).

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[20]See *Mills v. Electric Auto-Lite Co.*, supra, 396 U.S. at 384; *Affiliated Ute Citizens v. U. S.*, supra, 406 U.S. at 153-54.

While the Fifth and Second Circuits do not attach any significance to this Court's use of the word "might" in connection with the materiality standard, a number of other courts are of a contrary opinion and find there has in fact been an alteration in the materiality standard.[21] The point definitely needs clarification. As the Second Circuit pointed out:

> "The point is obviously of more importance when a judge must instruct a jury than when, as here, the case is tried to him." 478 F. 2d at 1302, n. 22.

This was a jury case. If the Court's instruction was not warranted by the applicable law, Plaintiff and the members of his class are entitled to a new trial.

The Writ should be granted to deal with a substantial and recurring problem under the securities laws and to clarify the meaning of this Court's decision in the *Mills* and *Ute* cases.

Eighth Question Presented:

WAS A STOCK OPTION AGREED TO BE GIVEN BY THE CHIEF EXECUTIVE OFFICER OF THE ACQUIRING COMPANY TO THE CHIEF EXECUTIVE OFFICER OF THE PROXY SOLICITING COMPANY IN CONNECTION WITH A MERGER, AND COVERING STOCK HAVING A MARKET VALUE OF $1,250,000.00, A MATERIAL OMISSION FROM THE PROXY MATERIALS AS A MATTER OF LAW?

The jury in this case found that in May, 1969, during the merger negotiations, Defendant Mize, the principal executive officer of Southdown, agreed that Southdown would give Defendant Range, the principal executive officer of Pearl, a qualified stock option to purchase 25,000 shares of Southdown Common Stock if the merger with Pearl was consummated (Special Issue 6). (Since the Common Stock traded at $50 a

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[21] See, *Gould v. American Hawaiian Steamship Co.*, 319 F. Supp. 795, 802 (D. Del. 1970); *Berman v. Thompson*, 312 F. Supp. 1031, 1033 (N.D. Ill.1970); *Feit v. Leasco Data Processing Equipment Corp.*, 332 F. Supp. 569, 570 (E.D.N.Y. 1971); *Beatty v. Bright*, 318 F. Supp. 169, 173 (S.D. Iowa 1970).

share on the date of issuance of the proxy statement, the stock covered by the agreement had an aggregate value of $1,250,-000.00). The jury also found that the existence of such option agreement was not adequately disclosed in the proxy statement (Special Issue 7). However, the jury found that the non-disclosure was *not* the omission of a material fact (Special Issue 8).

It was Plaintiff's contention in the Court of Appeals, and still is before this Court, that a stock option in such a very substantial amount which is required to be disclosed by the S.E.C.'s own proxy schedule,[22] and which had been offered to the chief executive officer of Pearl who was negotiating on the terms of a merger that was later represented to the shareholders to be the "result of arm's length negotiations" (Ex. Vol. at 18) was necessarily material as a matter of law.[23] This is particularly true where, as here, management recommended approval of the merger,[24] where an undisclosed competing merger offer had been involved,[25] and where the prospective recipient of the options was the principal representative of the merging company in determining whether to waive important conditions to the merger. The Court of Appeals ruled in this case that because it was revealed that Range was going to be employed by Southdown at a salary of $75,000 per year, and that a qualified stock option plan existed, the materiality of Range's stock option was no longer to be deemed material as a matter of law (as held by all the foregoing authorities), but was a matter within the legitimate province of the jury. 489 F. 2d at 604-605.

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[22]See Schedule 14A, Item 4 and instructions to Item 7(d).

[23]See, *Gould v. American Hawaiian Steamship Company, supra,* 331 F. Supp. at 994-995.

[24]See, *Mills v. Electric Auto-Lite,* supra, 403 F. 2d at 434; *Swanson v. American Consumer Industries, Inc.,* supra, 415 F. 2d at 1330; *Chris-Craft Industries, Inc. v. Bangor Punta,* supra, 480 F. 2d at 365-366.

[25]*Gerstle v. Gamble Scogmo, Inc.,* supra, 478 F. 2d at 1295; *United States Smelting & Refining Company v. Clevite Corp.,* CCH Fed. Sec. L. Rep. ¶92,691 (N.D. Ohio 1968).

We submit that the Court's conclusions regarding the Range stock option were seriously in error since the proxy statement, in describing Range's interest in the transaction, pictured him as receiving in connection with the merger, interests which essentially paralleled those he already held at Pearl. Range already had a salary "just short of $75,000 per year." Moreover, the disclosures regarding the stock option plan could not possibly have alerted the shareholders to Range's conflict of interest since the stock option plan did not even show that Range would participate in it.

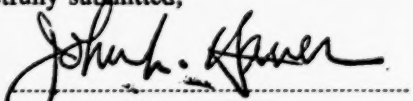
The 25,000-share stock option, on the other hand, was the one property right which Range did not already possess at Pearl. Its disclosure was therefore essential to alert the shareholders to the true extent of Range's financial stake in the Southdown merger ($1,250,000.00 worth). Furthermore, we do not perceive how the disclosures that were made could possibly have alerted the Pearl shareholders to Range's undisclosed role as a negotiator for Pearl, to the existence of the competing merger offer, or to the untruthfulness of the representation in the proxy material that the merger was the "result of arm's length negotiations." We therefore do not believe that the materiality of the undisclosed stock option *was* a matter within the legitimate province of the jury.

The Writ should be granted to preserve the legal integrity of the "materiality" standard, to uphold the viability of the S.E.C.'s disclosure requirements, to discourage the nondisclosure of substantial conflicts of interest, and to rectify a direct conflict with decisions of the Seventh and Second Circuits (see footnote 24).

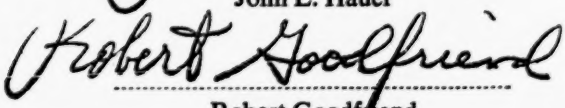
CONCLUSION

Under all the circumstances, Petitioner prays that his Petition for Writ of Certiorari be granted.

Respectfully submitted,



John L. Hauer



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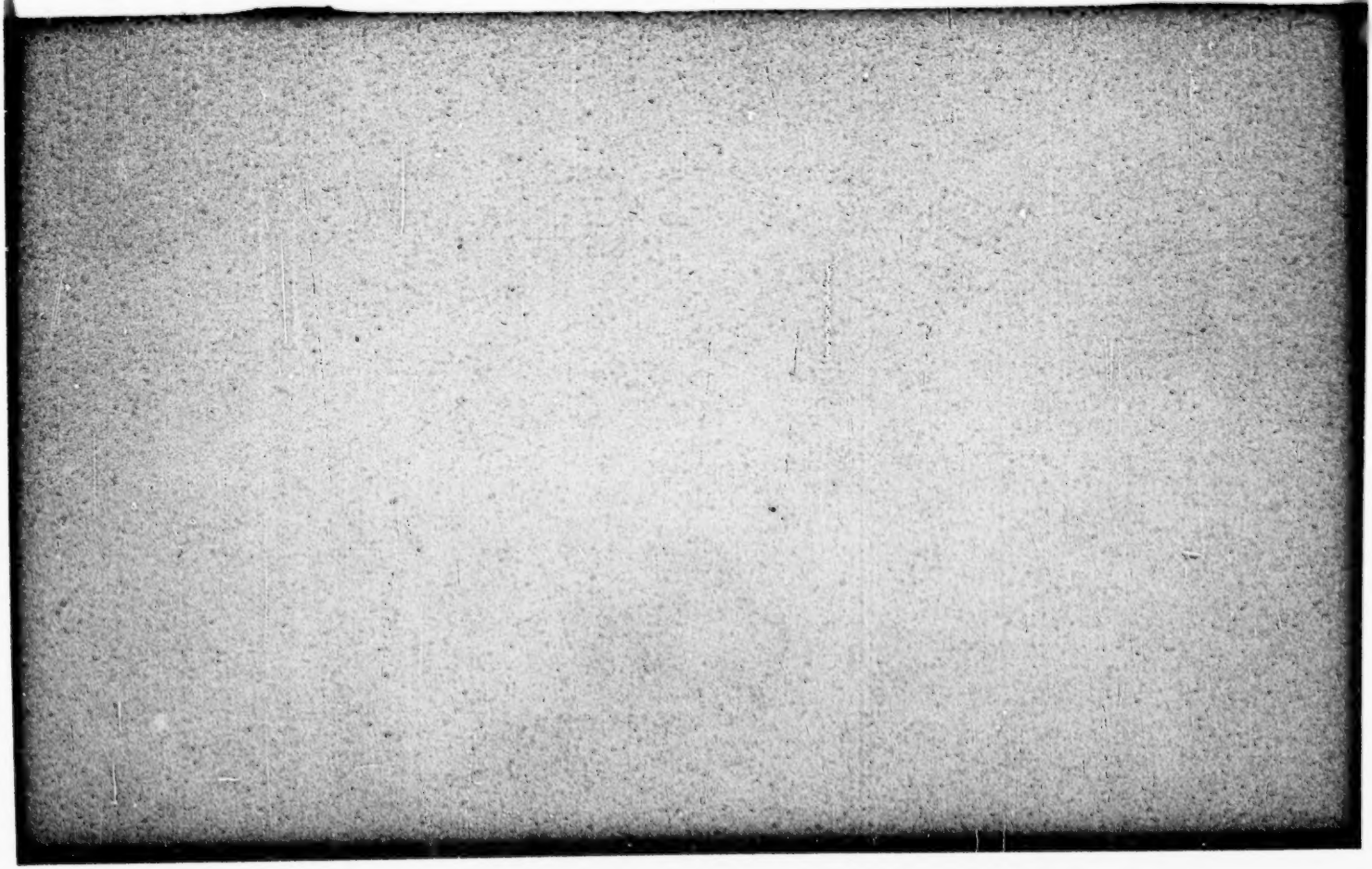
CERTIFICATE OF SERVICE

I, Robert E. Goodfriend, a member of the Bar of the Supreme Court of the United States, hereby certify that I have served the foregoing Petition for Writ of Certiorari on counsel for Respondents, by depositing same in the United States mails, postage prepaid, on this 24th day of May, 1974, addressed to: Mr. John Heid, Baker & Botts, 3000 One Shell Plaza, Houston, Texas 77002; Mr. Stan McMurry, Rain, Harrell, Emery, Young & Doke, 4200 Republic Bank Tower, Dallas 75201; and Mr. J. Burleson Smith, Cox, Smith, Smith, Hale & Guenther, 500 National Bank of Commerce Bldg., San Antonio, Texas 78205.

By

Robert Goodfriend



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APPENDIX

In The

Supreme Court of the United States

No. 73-1671

JOE L. SMALLWOOD,

Petitioner,

v.

PEARL BREWING COMPANY, et. al.,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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UNITED STATES CONSTITUTION, AMENDMENT 7

In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law.

STATUTES UNDER THE SECURITIES EXCHANGE ACT OF 1934

Section 14(a), 15 U.S.C.A. Section 78n (pocket part):

(a) It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect to any security (other than an exempted security) registered pursuant to section 781 of this title.

Section 10(b), 15 U.S.C.A. Section 78j:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules or regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 14(e), 15 U.S.C.A. Section 78n(e) (pocket part):

It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statement made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive or manipulative acts or practices, in connection with any tender offer or request or

invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, requests, or invitation.

PERTINENT RULES, REGULATIONS AND SCHEDULES UNDER THE SECURITIES EXCHANGE ACT OF 1934

Rule 14a-5, 17 C.F.R. § 240.14a-5

* * *

(b) Any information required to be included in the proxy statement as to terms of securities or other subject matter which from a standpoint of practical necessity must be determined in the future may be stated in terms of present knowledge and intention. To the extent practicable, the authority to be conferred concerning each such matter shall be confined within limits reasonably related to the need for discretionary authority. Subject to the foregoing, information which is not known to the persons on whose behalf the solicitation is to be made and which it is not reasonably within the power of such persons to ascertain or procure may be omitted, if a brief statement of the circumstances rendering such information unavailable is made.

Rule 14a-9, 17 C.F.R. § 240.14a-9

(a) No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

(b) The fact that a proxy statement, form of proxy or other soliciting material has been filed with or examined by the Com-

mission shall not be deemed a finding by the Commission that such material is accurate or complete or not false or misleading, or that the Commission has passed upon the merits of or approved any statement contained therein or any matter to be acted upon by security holders. No representation contrary to the foregoing shall be made.

Rule 10b-5, 17 C.F.R. § 240.10b-5

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

Schedule 14A. Item 4. Interest of Certain Persons in Matters to Be Acted Upon

(a) Solicitations Not Subject to § 240.14a-11. Describe briefly any substantial interest, direct or indirect, by security holdings or otherwise, of each of the following persons in any matter to be acted upon, other than elections to office:

(1) If the solicitation is made on behalf of management, each person who has been a director or officer of the issuer at any time since the beginning of the last fiscal year.

Schedule 14A. Item 7(d). Instructions.

* * *

3. (i) Where the total market value on the granting dates of the securities called for by all options granted during the period specified does not exceed $10,000 for any officer or director named in answer to paragraph (a) . . . this item need not be answered with respect to options granted to such person. . . .

OPINIONS BELOW

Smallwood v. Southdown, Inc., et al.,

United States District Court, Northern District of Texas

3-3632-B March 21, 1972

HUGHES, District Judge: This case involves the merger of Pearl Brewing Company into Southdown, Inc. on December 30, 1969. Joe L. Smallwood alleged that the named defendants violated federal securities laws and Texas law. Plaintiff sought damages for himself and as a representative of a class of Pearl shareholders, determined by the Court in a pretrial conference. In addition Smallwood sued derivatively on behalf of the old Pearl shareholders for damages resulting from an alleged breach of the merger agreement and violation of federal securities laws.

Smallwood made the following contentions:

1. The proxy statement of August 12, 1969 sent by Pearl to all stockholders announcing a meeting on September 9, 1969 to vote on the proposed merger of Pearl with Southdown was misleading in that it failed to contain certain material facts.

2. Pearl breached the terms of the merger by consummating the merger with Southdown on terms different from those set out in the proxy statement of August 12, 1969.

3. A letter dated November 18, 1969 to Pearl shareholders from Southdown failed to inform the shareholders of certain material facts in order to make the statements in the letter not misleading.

4. Certain acts or practices of Pearl and Southdown in connection with the merger operated as a fraud or deceit upon the Pearl shareholders.

5. There was a conspiracy between certain of the defendants to cause Pearl to be merged into Southdown on terms different

from those set out in the Plan of Merger approved by Pearl shareholders.

The case was tried before a jury. Motions for instructed verdict filed by the parties were overruled and thereafter the case was submitted to the jury on special issues with accompanying instructions. After the jury returned its verdict, the parties filed Motions for Judgment together with briefs.

After consideration of the jury verdict, the evidence, the briefs and other memoranda submitted by the parties, the Court concludes that the Plaintiff should not recover either in his class action or derivatively.

With reference to Plaintiff's contention that the proxy statement was misleading, the jury found against the Plaintiff in that (1) it did not fail to adequately disclose material facts, and (2) other facts omitted were not material.

The merger agreement, included in the proxy statement, contained a provision (paragraph 16(c)) that as a condition to Pearl's obligation to consummate the merger Southdown was to have procured an underwriting commitment in order to allow Pearl shareholders to sell up to 45% of their Southdown Preferred for $45.00. It was further provided that this provision was subject to waiver (Paragraph C) and the jury in Issue 9 found that the Pearl Board had not failed to adequately disclose this provision. This provision for waiver and the finding of the jury that there was not a failure to disclose is a complete bar to recovery by the Plaintiff.

There is nothing in the statutory law, the cases, or in any other authority which precludes the Board of Directors from waiving or modifying conditions when the right to waive is an express provision of the merger contract.

In the fall of 1969 it is well known that the stock market was in the worst decline since the early thirties. As a result it be-

came impossible for Southdown to secure an underwriting commitment which would allow Pearl shareholders to sell up to 45% of their Southdown Preferred for $45.00 per share. When this occurred, the Pearl Board at a meeting on December 22, 1969 approved a proposed agreement from Zapata Norness, Inc. to purchase at a price of $45.00 a share the 255,704 shares of Southdown Preferred which had been tendered in response to a letter of November 17, 1969 from Southdown to Pearl shareholders. The waiver by the Pearl Board of the condition in the merger plan to procure an underwriting commitment was not only expressly provided for but was a decision in which the Board exercised reasonable and prudent business judgment in order to facilitate the merger.

Not only was the waiver power lawful because corporate parties are generally free to contract such terms as seem desirable or appropriate, but also because as a matter of state corporate law it is lawful and proper for shareholders to empower their Board to waive specified conditions of a merger agreement. (Art. 5.01B(6) V. A. T. S.) That power permitted Pearl to exercise its business judgment in the best interest of its shareholders. The exercise of the waiver was in accordance with the terms of the merger agreement and as contemplated by state law.

It is Plaintiff's contention that Issues Nos. 15, 16, and 17 were answered in his favor and entitle him to recovery. These issues deal with the letter of November 18, 1969 to Pearl shareholders from Southdown. The jury found that the failure of this letter to disclose (1) that the December 2, 1969 date for tendering their stock was a change in the original Plan, (2) that the merger could be consummated without an underwriting agreement and without the period of ten days after the merger in which to tender their shares, and (3) that a corporation (Zapata) with a substantial investment in Southdown could be substituted

for an underwriter were omissions of material facts necessary in order to make the statements in the letter not misleading.

It has already been pointed out that the power to waive the underwriting conditions found in Special Issues Nos. 16 and 17 to have been omitted were set out in the merger agreement, which facts had been found in Issue No. 9 by the jury to have been adequately disclosed. The Plaintiff and the class he represents were aware of the waiver provision. There was no need to reiterate what was in the proxy material, and the omission from the November 18 letter could not have been relied on by them.

With reference to Issue No. 15, the date of December 2, 1969 for tender of Pearl stock was determined by the Board at its meeting on November 17, 1969. The underwriting agreement enclosed in the letter outlined the procedure for the purchase of Southdown stock. While this procedure may have changed the period of tender from that which an ordinary Pearl shareholder thought the merger contract granted, this interpretation is questionable. The ten days referred to in the merger agreement is the time in which the underwriters could purchase the Southdown Preferred which the shareholders had received for their Pearl stock. It does not have reference to the time for tendering their Pearl stock. But assuming it is a change from the merger agreement, the date of December 2, 1969 is clearly set out in the letter of November 18 under "Instructions to sell preferred stock" and the shareholders could not have been misled.

Even if it could be assumed that the actions of the Pearl Board on November 17 did not constitute a valid waiver of the alleged ten-day tender period, there is no causal relation between the change and any damages allegedly sustained by Plaintiff. For the change in the tender period to result in damage, it must have induced the Pearl shareholders to withhold tender

for the promised $45.00. Plaintiff contends that because the shareholders held their shares and did not tender, they were damaged by receiving stock of a lesser value. The Plaintiff, however, repeatedly contended that the damage resulted from Defendants' failure to secure an underwriting commitment which would have protected the value of the new Southdown Preferred Stock. But as heretofore stated, the underwriting commitment was legally waived and no damage can be recovered because of a legally waived condition. Clearly as Plaintiff argued, it was the possibility of receiving $45.00 which caused the shareholders to hold their stock. The change, if there was one in the ten day period for tender, could not have influenced a shareholder to hold his shares and not tender them by December 2, 1969.

The Plaintiff likewise relies heavily on Issue No. 19 for recovery. In it the jury found that the following acts operated as a fraud or deceit upon the Pearl shareholders: (1) the failure to inform the Pearl shareholders that the date for tender had been changed, (2) failure to inform that the merger could have been consummated without a firm commitment from a group of underwriters, (3) failure to inform that the merger could have been consummated without a tender period following the effective date of the merger, and (4) failure to inform Pearl shareholders that Zapata Norness, Inc. had a substantial interest in Southdown.

All of these matters concerned changes in the merger agreement which the Board could legally waive. There can be no fraud in doing what the Board was legally empowered to do. Additionally, as pointed out with reference to Issues Nos. 15, 16, and 17 there is no causal connection between the omissions and the alleged damages.

With reference to the issues dealing with conspiracy, while the jury found there was a conspiracy between Pearl and South-

down, they likewise found the conspiracy was not a proximate cause of the merger.

For the reasons stated, there has been no violation of federal securities law and there can be no recovery by Plaintiff either derivatively or representing a class. There were no misrepresentations or omissions of facts or deception concerning the changed conditions of the merger. The changes that were made were validly executed. All of the allegedly fraudulent acts were permissible because they came within the ambit of the waiver provision.

In addition to the matters submitted to the jury, the Plaintiff has contended that the November 18, 1969 letter and the enclosed documents constituted a "tender offer or request or invitation for tenders" which Sections 14(d) and (e) of the Exchange Act regulate. Sections 13 and 14 require that certain schedules be filed in connection with tender offers. The purpose of these sections is to provide to the shareholders and the investing public full and adequate disclosure of material facts by both the acquired and the acquiring companies involved in a "takeover bid." 2 U. S. Code Cong. & Ad. News 2818 (1968). Among the items which the companies must disclose are the following: (1) the type security and issuer involved; (2) the identity and background of the persons and companies involved; (3) the source and amount of funds or other consideration; (4) the purpose of the transaction; (5) the interest in securities of the issuer; (6) information concerning any contracts, arrangements, or understanding with respect to securities of the issuer; (7) information on the persons retained, employed, or to be compensated to accomplish the transaction. Without considering possible exemptions which may apply to the Defendants under these sections, the Court concludes that the Plaintiff can establish no damage arising from the failure to file the schedules because the Defendants had already disclosed through the

proxy statement, underwriting agreement, and the preliminary prospectus all of the pertinent facts which were within their knowledge at the time of the subject transactions.

Furthermore, neither of these sections applies to the transactions in issue. In this case the Defendants accomplished this merger by the proxy method. The companies submitted a merger contract to the shareholders and solicited approval by proxies. The merger agreement provided that there would be a tax-free stock-for-stock exchange and an option for a shareholder to obtain cash for a portion of this stock with a capital gains treatment. The legislative history of the Williams Act demonstrates that its purpose was to regulate "takeover bids." Southdown clearly did not seek to acquire control of Pearl through a cash tender offer, hostile or otherwise. The acquisition of Pearl was to be accomplished through a mutually agreed merger contract approved by the stockholders. Sections 14(d) and (e) are not applicable to this form of corporate acquisition.

There being no violation of either federal or State statutory provisions or common law which resulted in any damage to Plaintiff or to the members of the class he represents or to old Pearl Brewing Company, IT IS THEREFORE ORDERED, ADJUDGED, AND DECREED that Joe L. Smallwood, individually and as representative of a class, defined by the Court, take nothing. IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that Joe L. Smallwood suing derivately on behalf of old Pearl take nothing; and

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that Defendants go hence with their costs.

Joe L. SMALLWOOD, Plaintiff-Appellant,

v.

PEARL BREWING COMPANY, Southdown, Inc., Zapata Norness, Inc., Albert J. Range and D. Doyle Mize, Defendants-Appellees.

No. 72–2342.

United States Court of Appeals, Fifth Circuit.

Feb. 19, 1974.

Shareholder of corporation which merged with another corporation brought suit, individually, as representative of a class, and derivatively, against the two corporations and others, alleging a multitude of securities laws violations. The United States District Court for the Northern District of Texas, at Dallas, Sarah Tilghman Hughes, J., entered judgment in favor of defendants, and plaintiff appealed. The Court of Appeals, Wisdom, Circuit Judge, held that (1) both in his individual and representative capacities, plaintiff, as a purchaser and seller, had standing to assert rule 10b–5 violations in the merger transaction, (2) the standing plaintiff acquired through the merger permitted him to assert rule 10b–5 violations in letter of November 18, 1969 and later purchase of tendered shares by surviving corporation's controlling corporate shareholder, (3) rights under the Williams Act may be enforced through private action, (4) November 18 letter from surviving corporation to shareholders of merging corporation was a tender offer, (5) a bid to purchase securities is a tender offer even if unopposed by management of the target company, and (6) neither July 17 letter from merging

corporation to its shareholders nor proxy materials it sent out on August 12 violated the securities laws.

Affirmed.

1. Securities Regulation ⇐60

Rule 10b–5 has a specific and narrow task, namely, to protect purchasers and sellers of securities from fraud perpetrated in connection with the purchase or sale of any security. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

2. Securities Regulation ⇐131

A private right of action may be maintained under that provision of the Securities Exchange Act of 1934 relating to manipulative and deceptive devices, and under rule 10b–5 promulgated pursuant thereto. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

3. Securities Regulation ⇐120

Plaintiffs who are not alleged to be either purchasers or sellers of securities lack standing under rule 10b–5. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

4. Securities Regulation ⇐60

Purpose of that provision of the Securities Exchange Act relating to manipulative and deceptive devices is to keep the channels of interstate commerce, the mail, and national securities exchanges pure from fraudulent schemes, tricks, devices, and all forms of manipulation, and to outlaw the employment of manipulative or deceptive devices or contrivances, however novel or atypical. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

5. Securities Regulation ⇐64

To prevent the "Birnbaum" doctrine from limiting too severely the ability of rule 10b–5 to meet the broad purposes of the Securities Exchange Act of 1934, the term "seller" has been stretched beyond its common-law sense; for example, a merger may be treated as a purchase or sale. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

6. Securities Regulation ⇐120

When the common shares of plaintiff's corporation were converted into preferred shares of surviving corporation under merger agreement, plaintiff and the other members of his class effectively "sold" their shares and "purchased" shares of the surviving corporation on that day; accordingly, the plaintiff, in both his individual and representative capacities, as a purchaser and a seller, had standing to assert violations of rule 10b–5 in the merger transaction. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

7. Courts ⇐350.1(7)

Capacity of a corporation to sue or be sued in federal court is determined by the law of the state in which it was organized. Fed.Rules Civ.Proc. rule 17(b), 28 U.S.C.A.

8. Securities Regulation ⇐2

In interpreting the securities laws, Court of Appeals must keep in mind the broad congressional purpose.

9. Securities Regulation ⇐2

The securities laws are intended to protect investors, not merely to test the ingenuity of sophisticated corporate counsel.

10. Corporations ⇐202

The fact that exchange of stock between merging and surviving corporations was not made through the merging corporation, as it presumably could have been, was not controlling on the question of whether shareholder of the merging corporation had standing to sue derivatively for alleged securities law violations. Securities Exchange Act of 1934, §§ 3(a)(13, 14), 10(b), 15 U.S.C.A. §§ 78c(a) (13, 14), 78j(b).

11. Federal Civil Procedure ⇐164

Although the district court is empowered to dismiss a derivative action should it appear that the plaintiff does not adequately represent the shareholders in enforcing the rights of the corporation, a finding in the alternative is not required

before a derivative action may go forward; rather, the burden is on defendants to obtain a finding of inadequate representation. Fed.Rules Civ.Proc. rule 23.1, 28 U.S.C.A.

12. Corporations ⇐202
Securities Regulation ⇐120

Under the "Birnbaum" doctrine, it was clear that in none of merging corporation's shareholder's three actions, individual, class or derivative, did he have standing, independent of the merger transaction, to attack as violative of the securities laws the letter of November 18, 1969 sent by surviving corporation to the shareholders of merging corporation, or the purchase by the surviving corporation's controlling shareholder of shares of common stock of the merging corporation. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

13. Securities Regulation ⇐120

Shareholders who allege that fraud induced them to retain their stock do not have rule 10b–5 standing in damages actions. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

14. Securities Regulation ⇐202

Stockholder of corporation which merged into another corporation did not have standing on a "forced seller" theory, to challenge as violative of the securities laws a letter sent by surviving corporation to shareholders of merging corporation and the purchase of shares of the merging corporation by surviving corporation's controlling corporate shareholder, since, inter alia, the merger deprived plaintiff of none of the incidents of ownership of his stock. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

15. Securities Regulation ⇐120

As the purchase by surviving corporation's controlling shareholder of shares deposited by shareholders of merging corporation was tied closely enough to the merger to be considered "in connection with" that transaction, the standing acquired by plaintiff, a shareholder of the merging corpora-

tion, through the merger permitted him to assert violations of rule 10b–5 in respect to the stock purchase and a prior letter relative thereto sent by surviving corporation to shareholders of merging corporation. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

16. Securities Regulation ⇐52

Coverage provision of the Securities Exchange Act of 1934 relating to tender offers extends to all tender offers. Securities Exchange Act of 1934, § 14(e), 15 U.S.C.A. § 78n(e).

17. Securities Regulation ⇐105

To charge in federal court violations of the Securities Exchange Act provision relating to tender offers, a private plaintiff need not be a purchaser or seller of any securities, as he must be to sue under rule 10b–5. Securities Exchange Act of 1934, §§ 10(b), 14(e), 15 U.S.C.A. §§ 78j(b), 78n(e).

18. Securities Regulation ⇐131

A private right of action may be inferred from the tender offer provisions of the Williams Act. Securities Exchange Act of 1934, § 14(e), 15 U.S.C.A. § 78n(e).

19. Securities Regulation ⇐105

Under Securities Exchange Act provision relating to tender offers, a plaintiff may gain standing to sue if he has been injured by fraudulent activities of others perpetrated in connection with a tender offer, whether or not he has tendered his shares; and a nontendering shareholder may complain derivatively of injury to the target company. Securities Exchange Act of 1934, § 14(e), 15 U.S.C.A. § 78n(e).

20. Securities Regulation ⇐52, 105

Surviving corporation's letter of November 18, 1969, which was intended to implement sell-out provision of merger agreement and which informed shareholders of merging corporation that, in order to sell the shares of the surviving corporation received by them in exchange under the merger, they would have to tender their stock by stated date constituted a "tender offer," and merging corporation's shareholder

could allege violations of the Williams Act in connection with it. Securities Exchange Act of 1934, § 14(e), 15 U.S.C.A. § 78n(e).

See publication Words and Phrases for other judicial constructions and definitions.

21. Securities Regulation ⇐52

Immediate purpose of the Williams Act was to protect investors from unscrupulous corporate raiders who could force shareholders into making a hasty, uninformed decision to sell by offering to buy a portion of the target corporation's securities at a premium price; if the shareholder responded quickly to the offer, he might not learn in time the true risks of his decision, but if he waited, he might lose his opportunity to gain a premium price for his securities because others had already tendered to the offeror the number of shares it required. Securities Exchange Act of 1934, § 14(e), 15 U.S.C.A. § 78n(e).

22. Securities Regulation ⇐52

Although takeover bids formed the immediate catalyst to precipitate the Williams Act, the Act's definition of "tender offer" is not so restricted. Securities Exchange Act of 1934, § 14(e), 15 U.S.C.A. § 78n(e).

23. Securities Regulation ⇐2

Securities laws must be interpreted so as to effectuate their broad remedial purposes.

24. Securities Regulation ⇐52

Williams Act applies to statements by management of the target company, as well as by the tender offeror. Securities Exchange Act of 1934, § 14(e), 15 U.S.C.A. § 78n(e).

25. Securities Regulation ⇐52

A bid to purchase securities is no less a "tender offer" within the meaning of the Williams Act when it is unopposed by management of the target company than when it is opposed. Securities Exchange Act of 1934, § 14(e), 15 U.S.C.A. § 78n(e).

26. Securities Regulation ⇐52

A corporation does not become a tender offeror simply by proposing a paper exchange of securities; rather, there must be contemplated some change of control. Securities Exchange Act of 1934, § 14(e), 15 U.S.C.A. § 78n(e).

27. Securities Regulation ⇐52

Securities Exchange Act provision relating to tender offers does not require that the person or company inviting the tenders make the ultimate purchase; rather, a "tender offer" within the meaning of the Williams Act may be made by those acting in concert with others as well as those acting alone. Securities Exchange Act of 1934, § 14(e), 15 U.S.C.A. § 78n(e).

28. Securities Regulation ⇐50

Even a communication well in advance of any formal request for a proxy may be made under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy and thus may be considered a "solicitation" within the proxy rules; furthermore, a letter not itself requesting proxies may be subject to the proxy rules as part of a continuous plan ending in solicitation which prepares the way for its success. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a).

See publication Words and Phrases for other judicial constructions and definitions.

29. Securities Regulation ⇐50

Securities Exchange Act provision relating to proxy statements is not intended to sacrifice utterly speed of disclosure in order to insure completeness, since prompt disclosure helps to insure not only that all investors have at all times equal access to market information but also that investors are provided a continuing opportunity to make knowing, intelligent decisions; accordingly, proxy statements describing an event that has just occurred should be examined under a less powerful glass than similar statements made after a period sufficient for careful study and reflection has passed. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a).

30. Securities Regulation ⇐50

Securities law provisions relating to proxy statements were not violated by July 17, 1969 letter sent by merging corporation to its shareholders, since the letter, under all the circumstances, was not reasonably calculated to result in the procurement of a proxy. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a).

31. Securities Regulation ⇐51, 147

Proxy materials sent by merging corporation to its shareholders on August 12, 1969 did not violate pertinent provision of the Securities Exchange Act, since merging corporation's power to waive surviving corporation's obligation to obtain an underwriting commitment was adequately disclosed by reason of its inclusion in the merger agreement which was attached as an appendix to the proxy statement, and since the stock option of merging corporation's vice-president was not so obviously important to an investor that reasonable minds could not differ on the question of materiality, i. e., the question of materiality was within jury's legitimate province. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a).

32. Courts ⇐406.1(18)

Where special issue, which plaintiff alleged confused the jury because of its double negative aspect, was virtually identical to the special issue plaintiff had requested, judicial economy precluded giving plaintiff a second bite at the apple when any responsibility for confusing the jury had to fall at his own door.

33. Federal Civil Procedure ⇐2371

Jurors may not impeach their verdict.

34. Federal Civil Procedure ⇐2374

Whether or not jury misunderstood the charge of the court is not a question to be reexamined after the verdict has been rendered.

35. Securities Regulation ⇐50

Those who draw proxy statements must be fair and sensitive to the needs of shareholders in exercising their rights of corporate suffrage, but they need not be clairvoyant; and it is enough that proxy statements be complete and not misleading in light of the circumstances existent and reasonably anticipated at the time the statements are distributed. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a).

36. Securities Regulation ⇐50

Position and emphasis given in a proxy statement to waiver powers invoked for any cause reasonably to be anticipated at the time proxy statement is distributed deserve close judicial scrutiny. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a).

37. Securities Regulation ⇐50

With respect to the omission of a material fact in a proxy statement, the test of materiality is whether a reasonably prudent person would attach importance to the information in determining his course of action, not whether a reasonable shareholder might consider the information important in determining how to vote. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a).

38. Securities Regulation ⇐50

It is essential that recipients of a proxy statement know that a director's recommendation contained therein is not completely disinterested. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a).

39. Securities Regulation ⇐143

The same elements must be proved to establish a violation of either rule 10b–5 or that section of the Securities Exchange Act which adopted the substantive language of the rule's second paragraph. Securities Exchange Act of 1934, §§ 10(b), 14(e), 15 U.S.C.A. §§ 78j(b), 78n(e).

40. Securities Regulation ⇐50

Prior disclosure in one communication to its shareholders will not automatically excuse omissions by corporation in another communication. Securities Exchange Act of 1934, §§ 10(b), 14(e), 15 U.S.C.A. §§ 78j(b), 78n(e).

41. Securities Regulation ⇐50

Adequacy of a corporation's disclosures in a proxy statement is a function of position, emphasis, and reasonable anticipation that certain future events will occur. Securities Exchange Act of 1934, § 14(a, e), 15 U.S.C.A. § 78n(a, e).

42. Securities Regulation ⇐144

Even assuming that letter of November 18, 1969 from surviving corporation to the shareholders of merging corporation, instructing them in the procedures necessary for the sale of their stock, contained omissions of material facts, plaintiff failed to establish that the surviving corporation and the other defendants acted with any culpability and plaintiff therefore failed to establish a violation of the securities laws. Securities Exchange Act of 1934, §§ 10(b), 14(e), 15 U.S.C.A. §§ 78j(b), 78n(e).

43. Securities Regulation ⇐117, 143

In cases alleging violations of rule 10b–5, some culpability is required as an element of proof; some culpability, beyond mere negligence, is required. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

44. Courts ⇐406.5(9)

Special issue not submitted to the jury would be deemed found in accord with the judgment returned by the jury. Fed.Rules Civ.Proc. rule 49(a), 28 U.S.C.A.

45. Securities Regulation ⇐62

Merging corporation's waiver of underwriting commitment as a condition precedent to the merger was not fraudulently exercised, since the evidence, in suit charging violations of the Securities Exchange Act and rule 10b–5, failed to indicate that the merging corporation's board of directors, in

exercising the waiver power, used anything other than sound business judgment, considering the fact that the possibility of an underwriting had disintegrated and that, if the merger were canceled, the value of the merging corporation's stock would have plummeted. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

46. Securities Regulation ⇐51, 52, 62

In suit charging violations of the proxy rules, the tender offer provisions of the Williams Act, and rule 10b–5 in connection with a corporate merger, merging corporation's board of directors, who properly waived underwriting commitment as a condition precedent to consummation of the merger, acted properly in substituting another purchaser for the underwriters, since the board, by obtaining the other purchaser for that stock which had been tendered under the merger agreement's underwriting provision, simply saved the benefit of their decision to those shareholders who had elected to sell. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

47. Securities Regulation ⇐62

As the evidence in suit charging violations of the Securities Exchange Act and rule 10b–5, established that merging corporation never actually promised its shareholders the right to tender their stock within ten days after merger, the merging corporation's board of directors did not have to formally waive such right. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

Appeal from the United States District Court for the Northern District of Texas.

Before WISDOM, DYER and INGRAHAM, Circuit Judges.

WISDOM, Circuit Judge:

This appeal raises a variety of difficult questions under the Securities Exchange Act of 1934. Suing individually, as the representative of a class, and derivatively, Joe L. Smallwood,

plaintiff-appellant, charged the defendants with a multitude of sins, including violations of the Proxy Rules, the tender offer provisions of the Williams Act, and Rule 10b–5. The defendants demanded a jury trial. After special issues were submitted to the jury and returned, the district court ruled that no violations of the securities laws had been established. We affirm.

I.

FACTS

The story begins innocuously enough in the summer of 1968 with the commencement of a search by Pearl Brewing Company for a suitable merger partner.[1] Seeking further diversification, Pearl, a Texas corporation engaged in the manufacture of beer, soft drinks, and candy, rejected feelers from other firms in the consumer foods industry. Then, in the spring of 1969, three new merger candidates appeared—Aztec Oil & Gas Company, Infotech, and Southdown, Inc. Infotech was a start-up enterprise with no business history, and its merger offer was quickly dismissed. Aztec, a natural gas producer, offered a straight stock-for-stock exchange. Southdown, a Louisiana corporation with interests in sugar production, oil and gas, and real estate, originally offered to purchase a controlling interest in Pearl stock for cash.[2] After some preliminary negotiations, Southdown altered its proposal to provide the option of a stock-for-stock exchange in a tax-free merger.[3] The Aztec and Southdown proposals were referred

1. The underlying reasons for Pearl's search for a merger partner were (1) the increased competition national breweries exerted on regional breweries and (2) the illness of its chief executive, Otto Koehler.

2. In August 1969 Southdown acquired Canal Assets, Inc., which was engaged in rice milling and irrigation, and owned land and mineral interests.

3. Southdown's proposal was that "the present owners of the controlling interest in Pearl (i. e. holders of at least 45% of the outstanding Pearl stock) would enter into an agreement with [Southdown] to sell their stock for $45 per share in cash or, at their option,

to Duff, Anderson & Clark, Inc., a Chicago financing and consulting firm, for study.

On June 26, 1969, representatives of Duff, Anderson & Clark orally reported to the Pearl Board of Directors that in their opinion both proposals would benefit Pearl, but that the Aztec offer was slightly the better of the two because it had "more upside potential near term". When the Pearl Board met again on July 7, 1969, representatives of Aztec and Southdown appeared to present their proposals. After the presentations, one of Pearl's attorneys reported to the Board that El Paso Natural Gas Company, Aztec's chief customer, was under no obligation to continue purchasing gas from Aztec. The Pearl Board then informally indicated its approval of the Southdown proposal and instructed Pearl's attorneys to meet with Southdown's attorneys in an attempt to work out a merger agreement.

A merger agreement between Pearl and Southdown was approved by the Pearl Board on July 11, 1969. The agreement provided that Pearl would be merged into Southdown and that for each share of Pearl common stock owned a shareholder would receive one share of Southdown convertible preferred stock. Pearl's obligation to consummate the merger was subject to "the fulfillment (or waiver by Pearl in writing)" of certain conditions, the most important of which would permit Pearl shareholders to "sell out" at least 45 percent of their newly acquired Southdown preferred stock on consummation of the merger for $45 a share:

"Southdown shall have procured a firm commitment from a group of underwriters (which commitment shall be satisfactory in form and substance to the Board of Directors of Pearl) by which such underwriters will agree, for a period of ten days following the Effective Date, to purchase from those stockholders who desire to sell the same, at a price of

in exchange for Southdown's $1.80 Cumulative Convertable Preferred Stock in a tax-free merger".

$45 net per share, up to 45 percent of the shares of Southdown Preferred Stock into which the shares of Pearl Stock held by such stockholders on the Effective Date will have been converted upon consummation of the merger."

Testimony at trial indicated that the purpose of requiring Southdown to gain a firm underwriting commitment was to accomplish the sell-out provision of the plan without making the merger taxable to Pearl shareholders. Although Southdown was willing to buy up to 45 percent of Pearl's stock for cash, Pearl's attorneys were of the opinion that if Southdown paid cash in addition to securities the merger would lose its tax-free status under Section 354 of the Internal Revenue Code of 1954, and the exchange of shares in the merger would become a taxable event to Pearl shareholders. Jack Guenther, one of Pearl's attorneys, testified that in his negotiations with Southdown he obtained the Pearl Board's right to waive the underwriting commitment so that Southdown could not avoid the merger by failing to procure an underwriting commitment. The purpose of the waiver power was explained to the Board when the Board approved the merger agreement. There was no testimony that it was anticipated at that time that an underwriting commitment would not prove possible. To the contrary, Guenther had received confirmation from Lehman Brothers, an investment banker, that a firm commitment was feasible.

According to testimony in the record the provision that the underwriters would purchase "for a period of ten days following the Effective Date . . . from those stock holders who desire to sell" was intended to indicate when the underwriters would purchase, not when shareholders would tender their shares for sale. The testimony at trial was that permitting shareholders ten days after the merger to tender their shares for sale to underwriters would be inconsistent with underwriters' requirements that they know before purchase the number of shares they must market.

On July 17, 1969, Pearl advised its shareholders by mail of the proposed merger with Southdown. The letter indicated that both the Pearl and the Southdown Boards of Directors believed the merger to be mutually beneficial and recommended shareholder approval. Enclosed with the letter was a copy of a press release describing the basic terms of the merger proposal and stating: "It is a condition to Pearl's obligation to consummate the merger that, on the effective date of the merger, Southdown shall have obtained an underwriting commitment affording the former Pearl stockholders the opportunity to sell, at $45.00 net per share, up to 45% of the Southdown preferred stock received by them in the merger." The power of the Pearl Board to waive the underwriting commitment was not mentioned.

Pearl management communicated again with the shareholders on August 12. The materials distributed that day included a cover letter, a notice of a special shareholders meeting to be held on September 9, 1973, a proxy, and a proxy statement with appendices. The first sentence of the proxy statement referred the reader to the merger agreement between Pearl and Southdown and indicated that a copy of the agreement could be found attached as Appendix II. The agreement, of course, contained the conditions of Pearl's obligation to merge written in full, including the power of the Pearl Board to waive them. Nowhere else in the materials was the waiver power mentioned, although the underwriting condition was referred to four times.

The proxy statement revealed that Albert Range, Executive Vice President of Pearl, would be employed by Southdown under a five-year employment contract at $75,000 per annum and that Range would become a director of Southdown. Moreover, the proxy statement indicated, as a result of the merger Range's 2,620 shares of Pearl stock would be converted into an equal number of Southdown shares. Although during preliminary negotiations between Southdown and Pearl, D. Doyle Mize, the Chairman of Southdown's Board,

had promised Range a stock option of 25,000 shares, the proxy materials did not disclose that fact.

On September 9, 1969, the shareholders voted 1,253,337 shares to 35,449 in favor of the merger. December 10, 1969, was tentatively set as the merger date.

To implement the sell-out provision of the merger agreement, Southdown mailed to the Pearl shareholders, on November 18, 1969, a cover letter, a draft of an underwriting agreement, a preliminary prospectus, and forms. The cover letter restated Southdown's obligation to obtain an underwriting commitment, but did not refer to the ten-day period following the merger during which the underwriters would purchase the stock. The shareholders were informed that to sell their shares of Southdown preferred stock to the underwriters upon consummation of the merger they must tender their Pearl stock certificates, with the appropriate deposit forms, to be in the hands of designated exchange agents "prior to 3:30 p. m., EST, on December 2, 1969". By December 2 approximately 545,000 shares, about 58.5 percent of the outstanding Pearl stock, had been deposited.

Through the summer and into the fall of 1969 the price of Southdown common stock had run counter to a general downward trend in the securities market. Testimony indicated that Lehman Brothers had continued to believe, and communicated this belief to Pearl's attorneys and Southdown, that a syndicate of underwriters would purchase up to 45 percent of the Southdown preferred stock at $45 a share. Late in November, however, the price of Southdown common declined precipitously. Lehman Brothers communicated to Southdown that an underwriting for more than 250,000 shares would not be possible. After talking to Mize on December 3, Range wrote to 25 Pearl shareholders, each of whom owned 5,000 or more shares of Pearl stock. He requested that those addressees who had deposited more than 25 percent of their stock for sale reduce their deposit to 25 percent. In response to this request, the number of deposited shares was reduced to ap-

proximately 255,000. Negotiations continued between Southdown and Lehman Brothers, but as the price of Southdown common continued to drop, an underwriting for even 255,000 shares became increasingly doubtful. Southdown discussed with Lehman Brothers indemnifying the underwriters for a loss of up to $1,000,000 on the resale of the Southdown preferred. Although Lehman Brothers tentatively agreed to this plan, the value of Southdown stock dropped to the point where Lehman Brothers considered that even $1,000,000 was insufficient.

While serious discussions were still continuing between Southdown and Lehman Brothers, on December 13 discussions began between Southdown and Zapata Norness, Inc., a controlling shareholder of Southdown. According to Mize's testimony, talks with Zapata were initiated on the theory that if Southdown should pay $1,000,000 to obtain buyers for the 255,000 deposited shares, it should pay that amount to Zapata. The idea of paying Zapata $1,000,000 to purchase the shares of Southdown preferred was discarded when Southdown was advised by its attorneys that such a payment would cause the merger to be considered a taxable transaction. Nevertheless, discussion with Zapata continued, and Zapata agreed to purchase the deposited shares for $45 a share.

The merger agreement provided that it was terminable by either party unilaterally if the merger was not consummated by December 31. On December 22, 1969, the Board of Directors of Pearl met to consider the status of the merger plans. At the meeting, the Pearl Board voted to accept Zapata's offer and approved the consummation of the merger. On December 30, 1969, Southdown and Pearl merged. Zapata then purchased the deposited shares for $45 each.

At the trial below the jury found that immediately before the merger on December 30 Pearl common stock was worth $45 a share. Each share of Southdown preferred would have been worth $45 had the merger been consummated "in accordance with the terms and conditions set forth in the agreement

and plan of merger". The jury found, however, that on actual consummation of the merger each share of Southdown preferred was worth only $37.80. Still, the price of Pearl stock had risen from about $30 to over $40 during the summer and fall of 1969. Had the merger plans been abandoned, the jury found, Pearl stock would have plummeted to $21.80 per share.

Joe Smallwood, the plaintiff-appellant, owned 200 shares of Pearl stock and acted as custodian for 600 shares owned by his daughters. He attempted to tender these 800 shares pursuant to the November 18 letter, but he missed the deadline of 3 P.M., December 2, 1969, and his tender was rejected. On February 5, 1970, he filed an individual, class, and derivative suit against Pearl, Southdown, Zapata, Albert Range, and D. Doyle Mize, alleging violations of Sections 10(b), 14(a), and 14(e) of the Securities Exchange Act of 1934 and Rules 10b–5, 14a–3(a), 14a0(a) and 14d–1 promulgated thereunder.[4] The district court defined the plaintiff's class as: "All those who were shareholders of Pearl Brewing Company on August 8, 1969 [the record date for the special shareholders meeting to vote on the merger] except Albert J. Range, those Pearl shareholders who later sold 100% of their Southdown preferred stock to Zapata Norness, Inc. for $45 per share, and those stockholders who have advised the Court prior to receipt of 'Notice of Class Action' of their desire not to be included in the class."

After a lengthy trial, the case was submitted to the jury on special issues. In addition to its findings on the market values, described above, the jury found:

> D. Doyle Mize agreed with Albert Range in May 1969 that Southdown would give Range a stock option of 25,000 shares should a merger between Southdown and Pearl be effectuated;

4. Smallwood does not allege violations of Section 14(d) or Rule 14d–1 on this appeal.

The agreement between Mize and Range was not adequately disclosed in the proxy statement, but this omission was not material;

The failure of the proxy statement to mention Aztec's offer or that Duff, Anderson & Clark had recommended the Aztec offer over Southdown's was not material;

The proxy statement did not fail to disclose adequately the power of the Pearl Board to waive the underwriting commitment; [5]

Because it eliminated the ten-day period after the merger date for the tender of 45 percent of the new Southdown preferred stock, the November 18, 1969, letter represented a material change in the merger plan;

By failing to inform Pearl shareholders that the December 2 date for tendering their stock was a change in the merger plan, the defendants omitted a material fact;

By failing to inform Pearl shareholders in the November 18 letter that the merger could be consummated without an underwriting commitment and without the ten-day period in which to tender their shares, the defendants omitted material facts; these failures were acts, practices, or courses of business which operated as a fraud or deceit upon the Pearl shareholders in connection with the merger;

By failing to inform Pearl shareholders in the November 18 letter that a corporation with a substantial interest in Southdown could be substituted for the underwriters, the defendants omitted a material fact; the failure to inform the Pearl shareholders that Zapata Norness, the party sub-

5. The jury also answered "Yes" to the following questions: "Do you find from a preponderance of the evidence that Plaintiff Smallwood relied on any misrepresentation of material facts in the Pearl proxy statement or on the omission of any material facts, if any you have found, in making his decision to vote in favor of the Pearl-Southdown merger on September 9, 1969?" Because the jury did not find that the proxy statement omitted or misrepresented any material facts, this question, and its answer, are irrelevant.

stituted for the underwriters, had a substantial ownership interest in Southdown was an act, practice, or course of business which operated as a fraud or deceit upon the Pearl shareholders in connection with the merger;

If the November 18 letter had not omitted to inform Pearl shareholders that the December 2 date for tendering their stock was a change in the merger plan, that the merger could be consummated without an underwriting commitment and without the ten-day period in which to tender their shares, and that a corporation with a substantial interest in Southdown could be substituted for the underwriters, a reasonable Pearl shareholder would have tendered his Pearl shares for $45 a share;

Between September 9 and December 30 Southdown and Pearl entered into a conspiracy to cause Pearl to be merged into Southdown on terms different from those in the merger agreement approved by the Pearl shareholders, but this conspiracy was not a proximate cause of the merger on December 30, 1969.

Upon receipt of the jury's responses to the special issues, the district court ruled that Smallwood should not recover individually, derivatively, or as representative of his class. Smallwood appeals.

II.

THRESHOLD QUESTIONS

First, we must examine whether Smallwood may properly raise before this Court his allegations of violations of Sections 10(b), 14(e), and 14(a) of the Securities Exchange Act of 1934 and Rules 10b–5, 14a–3(a), and 14a–9(a).

[1–3] A. *Rule 10b–5*—Rule 10b–5 has a specific and narrow task—to protect purchasers and sellers of securities from

fraud perpetrated "in connection with the purchase or sale of any security".[6] In Birnbaum v. Newport Steel Corp., 2 Cir. 1952, 193 F.2d 461, cert. denied, 343 U.S. 956, 72 S.Ct. 1051, 96 L.Ed. 1356, the Second Circuit refused standing under the Rule to plaintiffs who were not alleged to be either purchasers or sellers of securities. This Court has consistently followed the *Birnbaum* rule.[7] See Hooper v. Mountain States Securities Corp., 5 Cir. 1960, 282 F.2d 195, 201, cert. denied, 365 U.S. 814, 81 S.Ct. 695, 5 L.Ed.2d 693; Rekant v. Desser, 5 Cir. 1970, 425 F.2d 872, 877; Herpich v. Wallace, 5 Cir. 1970, 430 F.2d 792, 806. We are persuaded, moreover, that, at least with respect to actions for damages,[8] *Birnbaum* maintains its vitality in most circuits. See, e. g., Iroquois Industries, Inc. v. Syracuse China Corp., 2 Cir. 1969, 417 F.2d 963, 968; Greenstein v. Paul, 2 Cir. 1968, 400 F.2d 580, 581; City National Bank v. Vanderboom, 8 Cir. 1970, 422 F.2d 221, 228, cert. denied, 399 U.S. 905, 90 S.Ct. 2196, 26 L.Ed.2d 560. But see

6. 17 C.F.R. § 240.10b–5. Rule 10b–5 is promulgated under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j. There is no question of a private right of action under Section 10(b) and Rule 10b–5. See, e. g., Herpich v. Wallace, 5 Cir. 1970, 430 F.2d 792, 803; Reed v. Riddle Airlines, 5 Cir. 1959, 266 F.2d 314.

7. We understand the issue of standing to be "whether [Smallwood] is an appropriate party to be seeking relief on account of defendants' illegal conduct". Chris-Craft Industries, Inc. v. Piper Aircraft Corp., 2 Cir. 1973, 480 F.2d 341, 359 n. 11. See also Herpich v. Wallace, *supra*, 430 F.2d at 805.

8. Some courts have explicitly relaxed the *Birnbaum* requirement for actions seeking injunctive relief: "[W]e do not regard the fact that plaintiffs have not sold their stock as controlling on the claim for injunctive relief." Mutual Shares Corp. v. Genesco, Inc., 2 Cir. 1967, 384 F.2d 540, 546. See also Kahan v. Rosenstiel, 3 Cir. 1970, 424 F.2d 161, 173, cert. denied, 398 U.S. 950, 90 S.Ct. 1870, 26 L.Ed.2d 290; General Time Corp. v. Talley Industries, Inc., 2 Cir. 1968, 403 F.2d 159, cert. denied, 393 U.S. 1026, 89 S.Ct. 631, 21 L.Ed.2d 570; Ruckle v. Roto American Corp., 2 Cir. 1964, 339 F.2d 24. Mindful of Justice Marshall's warning that Rule 10b–5 questions "arise in an area where glib generalizations and unthinking abstractions are major occupational hazards", SEC v. National Securities, Inc., 1969, 393 U.S. 453, 465, 89 S.Ct. 564, 571, 21 L.Ed.2d 668, we express no comment as to the proper test for

Eason v. General Motors, 7 Cir. Dec. 28, 1973, 42 LW 2358. — F.2d —.

Against the reflection of *Birnbaum* we must examine in this case two related transactions—the merger between Pearl and Southdown and the cash purchase of approximately 255,000 shares of new Southdown preferred stock by Zapata Norness. Smallwood's standing under Rule 10b–5 depends on whether in each of these transactions he (or in his derivative claim, Pearl) may be treated as a purchaser or seller of securities.

[4, 5] The definitions of purchase and sale have sagged under the weight of courts' attempts to prevent ingenious minds from deflecting the statutory purposes of Section 10(b). The purpose of Section 10(b) is "to keep the channels of interstate commerce, the mail, and national securities exchanges pure from fraudulent schemes, tricks, devices, and all forms of manipulation", Hooper v. Mountain States Securities Corp., *supra*, 282 F.2d at 202, and "to outlaw the employment of manipulative or deceptive devices or contrivances, however novel or atypical", Herpich v. Wallace, *supra*, 430 F.2d at 806. See also S. E. C. v. Texas Gulf Sulphur Co., 2 Cir. 1968, 401 F.2d 833, 860 (en banc), cert. denied sub nom., Coates v. S. E. C. & S. E. C. v. Kline, 394 U.S. 976, 89 S.Ct. 1454, 22 L.Ed.2d 756; Kahan v. Rosenstiel, 3 Cir. 1970, 424 F.2d 161, 173, cert. denied, 398 U.S. 950, 90 S.Ct. 1870, 26 L.Ed.2d 290. To prevent the *Birnbaum* doctrine from limiting too severely the ability of Rule 10b–5 to meet the broad purposes of the Act, "seller" has been stretched beyond its common law sense. See, e. g., Hooper v. Mountain States Securities Corp., *supra* (corporation issuing its own stock); Vine v. Beneficial Finance Co., 2 Cir. 1967, 374 F.2d 627, cert. denied, 389 U.S. 970, 88 S.Ct. 463, 19 L.Ed.2d 460 (short-form merger). For our present purposes, the most important extension of the Rule 10b–5 definitions is the treatment of a merger as a purchase or sale.

standing under Rule 10b–5 in this Circuit when injunctive relief is sought. Smallwood does not seek injunctive relief on this appeal.

In S. E. C. v. National Securities, Inc., 1969, 393 U.S. 453, 467, 89 S.Ct. 564, 21 L.Ed.2d 668, the Supreme Court concluded that the shareholders of a merged corporation had "purchased" shares in the new corporation by exchanging their stock. As the Court pointed out, deception in a merger context has consequences not unlike those in a typical cash sale. The suit in the *National Securities* case was brought by the Securities Exchange Commission, and the Court cautioned that it was facing a question of statutory coverage, not standing. 393 U.S. at 467 n. 9. That distinction, however, has not proved potent. In Herpich v. Wallace, 5 Cir. 1970, 430 F.2d 792, shareholders of National American Life Insurance Company brought a derivative suit contending that, among other things, the defendants planned to defraud National American by causing it to acquire securities for an excessive price through a merger. This Court held that the Board of Director's resolution to merge was similar to a "partially consummated contract to buy or sell securities". 430 F.2d at 809.[9] Thus National American was treated as a purchaser-seller and was accorded standing under Rule 10b–5.[10]

[6] On December 30, 1969, all Pearl shares were converted into shares of Southdown preferred under the merger agreement. Smallwood and the other members of his class, therefore, effectively "sold" their shares of Pearl and "purchased" shares of Southdown on that day.[11] We think that in both his

9. See 15 U.S.C. § 78c(a)(13) & (14).

10. Other courts that have considered the status of mergers under Rule 10b–5 have reached a similar result. See Swanson v. American Consumer Industries, Inc., 7 Cir. 1969, 415 F.2d 1326, 1330; Mader v. Armel, 6 Cir. 1968, 402 F.2d 158, 161, cert. denied, 394 U.S. 930, 89 S.Ct. 1188, 22 L.Ed.2d 459; Dasho v. Susquehanna Corp., 7 Cir. 1967, 380 F.2d 262, 267, cert. denied, sub nom., Bard v. Dasho, 389 U.S. 977, 88 S.Ct. 480, 19 L.Ed.2d 470; Kohn v. American Metal Climax, Inc., E.D.Pa.1970, 322 F.Supp. 1331, 1358–1359 modified on other grounds 3 Cir., 458 F.2d 255, cert. denied, 409 U.S. 874, 93 S.Ct. 120, 34 L.Ed.2d 126.

11. It is not clear whether Smallwood has exchanged his Pearl certificates for Southdown ones. In any event, all Pearl shares have in actuality been converted into Southdown shares. Indeed, the

individual and representative capacities, Smallwood, as purchaser and seller, has standing to assert violations of Rule 10b–5 in the merger transaction.

[7] Whether Smallwood has derivative standing to question the merger is more difficult.[12] We have permitted share-

merger agreement stated that until surrendered the Pearl certificates "shall be deemed for all corporate purposes, other than the payment of dividends, to evidence ownership of the whole shares of Southdown Preferred Stock into which the same shall have been so changed and converted." Thus the shares of Pearl stock held by Smallwood and other members of his class have been "exchanged", regardless of the status of the certificates.

12. The appellees argue that Pearl lacks capacity to sue because Pearl has been merged with Southdown and has disappeared as a corporate entity. Capacity of a corporation to sue or be sued in federal court is determined by the law of the state in which it was organized. F.R.Civ.P. 17(b). Since Pearl was organized under the laws of Texas, Texas law controls. Neither Texas statutory nor case law speaks directly to the point, however, and we hesitate to ascribe a view to that state in the absence of some clear direction.

The problem is a sticky one. On the one hand granting capacity may create an anomalous situation where a corporation sues itself for its own benefit. Bokat v. Getty Oil Co., Del.Sup.Ct.1970, 262 A.2d 246, 249. See also Vine v. Beneficial Finance Co., 2 Cir. 1967, 374 F.2d 627, 637, cert. denied, 389 U.S. 970, 88 S.Ct. 463, 19 L.Ed.2d 460. Yet mergers are not so irrevocable that the constituent corporations may not be separated by the courts, see Mills v. Electric Auto-Lite Co., 1970, 396 U.S. 375, 386, 90 S.Ct. 616, 24 L.Ed.2d 593, and denying the shareholders of a merged corporation the capacity to sue may also create an anomaly; the shareholders of the surviving corporation may bring a derivative suit, while the same relief is denied to the shareholders of the disappearing corporation. Compare the instant case with Dasho v. Susquehanna Corp., 7 Cir., 380 F.2d 262, 265–266, cert. denied sub nom., Bard v. Dasho, 389 U.S. 977, 88 S.Ct. 480, 19 L.Ed.2d 470. Moreover, refusing to permit a corporation to sue where, as here, the very legality of the merger is questioned and the defendants include the management of the disappearing and surviving corporations may work an inequitable result. Miller v. Steinbach, S.D.N.Y.1967, 268 F.Supp. 255. Sometimes, of course, relief may be adequately provided through the class action device. See Vine v. Beneficial Finance Co., *supra* 374 F.2d at 637; Basch v. Talley Industries, Inc., S.D.N.Y.1971, 53 F.R.D. 9, 12. But class actions may not be appropriate for certain kinds of corporate remedies, such as unwinding mergers.

The appellees in this case cite us to several federal cases in which merged corporations were not permitted to maintain claims. Vine

holders to sue derivatively when they cannot personally fit within the ambit of the "purchaser" or "seller" requirement of Rule 10b–5. See Herpich v. Wallace, *supra*, 430 F.2d at 803; Rekant v. Desser, 5 Cir. 1970, 425 F.2d 872. But in each case granting derivative standing under Rule 10b–5, the pleadings have alleged either that the corporation itself sold its stock at too low a price or purchased other stock at too high a price.[13] Here, Pearl did not itself have possession of the stock exchanged in the merger. The appellees argue that because

v. Beneficial Finance Co., *supra*; Basch v. Talley Industries, Inc., *supra*; Heit v. Tenneco, Inc., D.Del.1970, 319 F.Supp. 884. In *Vine*, though troubled by the "meaninglessness" of the derivative claim, the Second Circuit denied the claim for another reason: it was unsuitable considering the relief desired. The Court felt that since the corporation had Class A and Class B shareholders, and the plaintiff sought recovery only for owners of Class A stock, he was better served by a class action. Both *Basch* and *Heit* were decided specifically under Delaware law and followed Delaware court decisions construing a Delaware statute, 8 Del.Code Ann. § 259. Furthermore, other federal cases have permitted minority shareholders to bring a derivative action on behalf of a corporation that no longer has an independent legal existence. See Jones v. Missouri-Edison Electric Co., 8 Cir. 1906, 144 F. 765, 776–777; Miller v. Steinbach, *supra*; cf. Ramsburg v. American Investment Co. of Illinois, 7 Cir. 1956, 231 F.2d 333, 336.

Texas has a statute not radically different from the Delaware statute that has been interpreted to deny capacity to a disappearing corporation in a merger. Compare Tex.Bus.Corp.Act art. 5.06, V.A.T.S. with 8 Del.Code Ann. § 259. This fact does not, however, make us any more eager to decide the question, which we feel should be left to the Texas courts. Because of our final disposition of this case, it is not necessary that we decide the capacity issue. We will assume derivative capacity without actually passing on the matter.

13. Wolf v. Frank, 5 Cir. 1973, 477 F.2d 467, cert. denied, — U.S. —, 94 S.Ct. 287, 38 L.Ed.2d 218 (1973) (allegation that corporation purchased securities for inadequate consideration); Bailes v. Colonial Press, Inc., 5 Cir. 1971, 444 F.2d 1241 (allegation that corporation issued securities for inadequate consideration); Shell v. Hensley, 5 Cir. 1970, 430 F.2d 819 (allegation that corporation purchased securities at inflated prices); Herpich v. Wallace, *supra*, (allegation that corporation would be caused to purchase securities at disadvantageous terms); Rekant v. Desser, *supra* (allegation that corporation issued securities for inadequate consideration); Hooper v. Mountain States Securities Corp., 5 Cir. 1960, 282 F.2d 195, cert. denied, 365

there was no proof below that Pearl bought or sold any securities in connection with the merger Smallwood has no standing to sue derivatively. To accept the appellees' position, however, would be to rest the applicability of Rule 10b–5 on the form and not the substance of the transaction.

[8–10] In interpreting the securities laws we must keep in mind the broad congressional purpose. Tcherepnin v. Knight, 1967, 389 U.S. 332, 336, 88 S.Ct. 548, 19 L.Ed.2d 564; Herpich v. Wallace, *supra*, 430 F.2d at 806. We must be careful that in deciding cases we contribute to the logical growth of regulation of the securities market and that we do not create simply another turn in an already complicated maze of regulation. The securities laws are intended to protect investors, not merely to test the ingenuity of sophisticated corporate counsel. See Crane Co. v. Westinghouse Air Brake Co., 2 Cir. 1969, 419 F.2d 787, 798, cert. denied, 400 U.S. 822, 91 S.Ct. 41, 27 L.Ed.2d 50; A. T. Brod & Co. v. Perlow, 2 Cir. 1967, 375 F.2d 393, 397. That the exchange of stock was not made through the Pearl Brewing Company, as it presumably could have been,[14] cannot be deemed controlling.

[11] The Securities and Exchange Act provides:

> "The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire.
>
> The terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of."

15 U.S.C. § 78c(a)(13) & (14). Pearl and Southdown entered into a contract whereby on the effective date of the merger all of Pearl's assets were transferred to Southdown in return for Southdown preferred stock issued to Pearl's shareholders. Pearl was the contracting party and provided the consideration. In effect, Pearl bought the Southdown stock for its

U.S. 814, 81 S.Ct. 695, 5 L.Ed.2d 693 (allegation that corporation issued securities for inadequate consideration).

14. See Fidelis Corp. v. Litton Industries, Inc., S.D.N.Y.1968, 293 F.Supp. 164, 169.

owners, the Pearl shareholders. Although not an active conduit or the ultimate recipient of the Southdown preferred stock, Pearl acted as a "purchaser" in all other respects. Little purpose would be served by hinging Smallwood's standing to sue derivatively under Rule 10b–5 entirely on the failure of Pearl to have physical possession of the shares, and we decline to do so.[15]

[12, 13] In addition to alleging fraud in the approval and consummation of the merger, Smallwood asserts that fraud tainted Southdown's letter of November 18, 1969, to Pearl's shareholders and the purchase of the 255,000 shares of Pearl stock by Zapata Norness Corp. Under the *Birnbaum* doctrine, it is clear that in none of Smallwood's three actions—individual, class, or derivative—does he have standing, independent of the merger transaction, to attack the November 18 letter or Zapata's purchase. The federal courts have consistently denied Rule 10b–5 standing in damage actions to shareholders who allege that fraud induced them to retain their stock. See VI L. Loss, Securities Regulation 3620 (1969). We endorse this line of decisions and hold that one does not acquire standing under Rule 10b–5 by refusing to tender securities.

[14] Nor does Smallwood gain standing that the letter and Zapata's purchase involved violations of the Rule by attempting to portray himself as a "forced seller" within the doctrine

15. The appellees also contend that the derivative action must fail for want of a finding by the trial court that Smallwood adequately and fairly represents the interests of other Pearl shareholders. Rule 23.1, F.R.C.P., provides in pertinent part: "The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association." Although the district court is thus empowered to dismiss a derivative action should it appear that the plaintiff does not adequately represent the shareholders in enforcing the rights of the corporation, a finding in the alternative is not required before a derivative action may go forward. See Bernstein v. Levenson, 4 Cir. 1971, 437 F.2d 756, 757. The burden is on the defendants to obtain a finding of inadequate representation, and no such finding was obtained here below.

enunciated in Vine v. Beneficial Finance Co., 2 Cir. 1967, 374 F.2d 627, cert. denied, 389 U.S. 970, 88 S.Ct. 463, 19 L.Ed.2d 460. Vine held shares of Class A common stock of Crown Finance Company, Inc. Although there were 624,870 shares of Class A stock, the 46,500 shares of Class B stock, owned principally by Crown's officers and directors, elected two-thirds of Crown's Board of Directors. Vine alleged a fraudulent scheme involving three steps: (1) Beneficial Finance Company purchased the Class B stock owned by the directors of Crown; (2) Beneficial made a cash tender offer to acquire 95 percent of Crown's total outstanding shares; (3) Crown was merged through a short-form merger with a wholly-owned subsidiary of Beneficial. Although Vine still held his Crown stock, that stock was itself worthless; he could realize value for his stock only by exchanging it with Beneficial for an amount fixed either by the terms of the merger or by appraisal. The Court held that Vine was a "seller" under Section 10(b) and Rule 10b–5. Requiring Vine to part with his shares before instituting suit would be a "needless formality".

Other decisions have followed the "forced seller" rationale of *Vine* to award standing to shareholders who retained their securities. In Crane Co. v. Westinghouse Air Brake Co., 2 Cir. 1969, 419 F.2d 787, cert. denied, 400 U.S. 822, 91 S.Ct. 41, 27 L.Ed.2d 50, the rationale was extended to a corporation which, after its tender offer was defeated and the target corporation had merged with a third corporation, faced the threat of antitrust action if it did not part with its interests in the target company. And in Coffee v. Permian Corp., 5 Cir. 1970, 434 F.2d 383, this Circuit applied the "forced seller" rationale to a shareholder whose shares were converted into a claim for cash by an allegedly fraudulent corporate liquidation. See also Travis v. Anthes Imperial Limited, 8 Cir. 1973, 473 F.2d 515; Dudley v. Southeastern Factor & Finance Corp., 5 Cir. 1971, 446 F.2d 303, cert. denied, 404 U.S. 858, 92 S.Ct. 109, 30 L.Ed.2d 101.

Of the "forced seller" cases, *Crane* seems the most far reaching; only in *Crane* did the plaintiff retain the realistic opportunity of selling or exchanging its stock in the open market. Even in *Crane*, however, the plaintiff had no practical alternative to disposing of its shares. Because of a change in corporate structure directly related to alleged fraud by the defendants, the plaintiff, though still holding the stock certificates, was deprived of a viable equity interest in an existing corporation.[16] Judge Davis stated well the limits of the "forced seller" theory when he said: "*Vine's* informing principle, carried forward in *Crane*, is that a shareholder should be treated as a seller when the nature of his investment has been fundamentally changed from an interest in a going enterprise into a right solely to a payment of money for his shares." Dudley v. Southeastern Factor & Finance Corp., 446 F.2d at 307.

Smallwood's claim has not been so reduced. If he has not already done so, he may exchange his Pearl shares for shares of Southdown preferred, which he may then trade in the securities market. Or he may hold his interest in Southdown indefinitely. Although an interest in Southdown may not be what he desires, Smallwood can scarcely contend that Southdown is not a "going concern". Finally, the merger between Southdown and Pearl deprived Smallwood of none of the incidents of ownership of his stock. He retains his right to vote, to share in corporate earnings, and to share in the assets of Southdown in the event of dissolution. See Greater Iowa Corp. v. McLendon, 8 Cir. 1967, 378 F.2d 783, 796. We believe, therefore, that this situation is distinguishable from each of the "forced seller" cases.

16. We reject the dicta in a footnote in *Crane*, 419 F.2d at 798 n. 13, that stockholders whose alternatives after the merger are to exchange their shares for shares of the surviving corporation or to enforce their appraisal rights may be forced sellers under the *Vine* principle.

[15] That Smallwood does not have standing, independent of the merger transaction, to argue that Zapata's purchase and Southdown's letter of November 18, 1969, violated Rule 10b–5 does not lay to rest the possibility somehow of his asserting these claims. Indeed, we are of the opinion that Zapata's purchase was tied closely enough to the merger to be considered "in connection with" that transaction. Thus the standing that Smallwood acquired through the merger permits him to assert violations of Rule 10b–5 in the November 18 letter and the later purchase by Zapata. We base this view on the Supreme Court's decision in Superintendent of Insurance v. Bankers Life & Casualty Co., 1971, 404 U.S. 6, 92 S.Ct. 165, 30 L.Ed.2d 128.

The facts of *Bankers Life* unfolded as follows Manhattan Casualty Co. was owned completely by Bankers Life. Two individuals, Standish Bourne and James Begole, negotiated with Bankers Life to buy Manhattan, and, eventually, Begole contracted with Bankers Life to make the purchase. To finance the purchase Bourne and Begole arranged a $5,000,000 loan from Irving Trust Company. Begole and Bourne then repaid the loan primarily by selling Manhattan's portfolio of government securities. Consequently, after the transactions Manhattan was $5,000,000 poorer, and Begole and Bourne had achieved ownership without expending any of their own money. To conceal the source of funds for their purchase of Manhattan, the new owners borrowed another $5,000,000 from Irving Trust and used this money to buy a certificate of deposit from Belgian American Trust for that amount payable to Manhattan. After another series of transactions designed to obfuscate further the true nature of the scheme, the same funds were used to pay off the second loan. At the conclusion of the charade, Manhattan's books showed only the sale of the government securities and the purchase of the certificate of deposit.

Facing this confusing set of transactions, the district court was unable to match any deception with a purchase or sale by

Manhattan.[17] Although Manhattan was a seller of the government securities, there was no fraud in connection with that transaction. And Manhattan was not a purchaser of its own stock or of the certificates of deposit; in the former transaction Manhattan was never intended to take title, and the latter transaction was a wash. Superintendent of Insurance v. Bankers Life & Casualty Co., S.D.N.Y.1969, 300 F.Supp. 1083, 1098–1101. The court held that the acts must be independently unlawful; although "employment of fraud in connection with a security transaction" was unlawful, "the effectuation of a security transaction in connection with a fraudulent activity" was not. Id. at 1102. The Court of Appeals affirmed, 2 Cir. 1970, 430 F.2d 355, but the Supreme Court reversed.

The Supreme Court rejected the lower courts' preoccupation with whether the fraud was in the total scheme or in the purchase or sale. Writing for the Court, Justice Douglas declared: "Section 10(b) must be read flexibly, not technically and restrictively. Since there was a 'sale' of a security and since fraud was used 'in connection with' it, there is redress under § 10(b)". 404 U.S. at 12. The Court made clear that a direct or close relation between the fraud and the securities transaction was not required. "The crux of the present case", the Court found, "is that Manhattan suffered an injury as a result of deceptive practices touching its sale of securities as an investor." Id. at 12–13.

Thus the Supreme Court in *Bankers Life* permitted a purchase by the plaintiff in one transaction to create standing to allege a violation of Rule 10b–5 in a different transaction when both transactions were alleged to be part of a single fraudulent scheme. With allegations of such a scheme, it is

17. The Superintendent of Insurance, as liquidator of Manhattan, asserted Manhattan's rights. The question of standing was determined as if Manhattan itself was the plaintiff. Superintendent of Insurance v. Bankers Life & Casualty Co., S.D.N.Y.1969, 300 F.Supp. 1083, 1086 n. 1.

sufficient under the *Bankers Life* test that the transaction involving a purchase "touch" the transaction alleged to involve the fraud. We do not hazard an opinion as to the outer limits of this test.[18] It is important that the standard be fleshed out by a cautious case-by-case approach. It is clear to us, nonetheless, that the November 18 letter and the purchase by Zapata were tied to the merger transaction sufficiently tightly to pass the "touch" test of Bankers Life. See also Drachman v. Harvey, 2 Cir. 1972, 453 F.2d 736 (en banc) (reversing panel decision, 453 F.2d 722, on authority of *Bankers Life*).

Pearl's directors testified that a large part of the attractiveness of the Southdown deal was that Pearl's shareholders would have a choice whether to accept cash or Southdown preferred stock as consideration for the merger. Furthermore, it is not at all clear that the merger agreement would have been approved by the shareholders without this provision. In essence, the sell-out provision provided an alternative to the statutory appraisal rights of the Pearl shareholder who harbored doubts about the value of the merger.[19] Rather than decline to vote for the merger and accept the appraised value of the stock as of the day before the vote, under the sell-out provision a shareholder could vote for the merger and retain the option to recover $45 for at least 45 percent of his shares should the merger look economically unattractive later. The sell-out provision offered the possibility of a shareholder's at least partially bailing out. There can be little doubt that it worked to sweeten significantly the merger deal.

[16] B. *Section 14(e)*—In 1968, when Congress passed the Williams Act, amending the Securities Exchange Act, it creat-

18. One commentator has suggested that the "touch" test of *Bankers Life* could be interpreted to cover "everything involving corporate mismanagement". Note, The Controlling Influence Standard in Rule 10b–5 Corporate Mismanagement Cases, 86 Harv.L.Rev. 1007, 1013.

19. Pearl shareholders had appraisal rights under Tex.Bus.Corp. Act, art. 5.12, V.A.T.S.

ed a new antifraud weapon. Congress provided in Section 14(e):

> "It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation."

15 U.S.C. § 78n(e). Were there ever any doubt from the unambiguous language that Congress intended the coverage of Section 14(e) to extend to *all* tender offers, that doubt has surely been dispelled by now. See Henry Heide, Inc., [1972–1973 Transfer Binder] CCH Fed.Sec.L.Rep. ¶ 78,838, at 81,836 (SEC Staff Letter, May 1, 1972). See also Butler Aviation International Inc. v. Comprehensive Designers, Inc., D.C., 307 F.Supp. 910, 914–915, aff'd, 2 Cir., 425 F.2d 842; 1 A. Bromberg, Securities Law: Fraud, § 6.3 (230); Note, The Developing Meaning of "Tender Offer" under the Securities Exchange Act of 1934, 86 Harv.L.Rev. 1250, 1259.

[17–19] To charge violations of Section 14(e) in federal court a private plaintiff need not be a purchaser or a seller of any securities, as he must be to sue under Rule 10b–5.[20] This

20. Section 14(e) does not explicitly provide for enforcement through private action. By analogy to J. I. Case Co. v. Borak, 1964, 377 U.S. 426, 84 S.Ct. 1555, 12 L.Ed.2d 423, however, courts have inferred a private right of action in that Section. See H. K. Porter Co. v. Nicholson File Co., 1 Cir. 1973, 482 F.2d 421, 424; Chris-Craft Industries, Inc. v. Piper Aircraft Corp., 2 Cir. 1973, 480 F.2d 341, 361. Other decisions have assumed a private right of action under Section 14(e) without discussion. See, e. g., Electronic Specialty Co. v. International Controls Corp., 2 Cir. 1969, 409 F.2d 937; Susquehanna Corp. v. Pan American Sulphur Co., 5 Cir. 1970, 423 F.2d 1075. See also E. Aranow & H. Einhorn, Tender Offers for Corporate Control 287 (1973). We take this opportunity to make explicit what has been implicit in this Circuit at least since 1970, see Susquehanna Corp. v. Pan American Sulphur Co., *supra*; a private

is the primary contribution of the Williams Act to the anti-fraud arsenal; under Section 14(e) a plaintiff may gain standing if he has been injured by fraudulent activities of others perpetrated in connection with a tender offer, whether or not he has tendered his shares. See Electronic Specialty Co. v. International Controls Corp., 2 Cir. 1969, 409 F.2d 937, 946; Neuman v. Electronic Specialty Co., N.D.Ill.1969, [1969–1970 Transfer Binder] CCH Fed.Sec.L.Rep. ¶ 92,591. And a non-tendering shareholder may complain derivatively of injury to the target company. See Fabrikant v. Jacobellis, E.D.N.Y. 1970, [1969–1970 Transfer Binder] CCH Fed.Sec.L.Rep. ¶ 92,-686.

[20] The remaining question in Smallwood's search for coverage under Section 14(e) concerns the meaning of "tender offer". Smallwood maintains that the November 18, 1969, letter from Southdown to Pearl's shareholders was a tender offer, or at least a "request or invitation for tenders", within the meaning of the Williams Act. The appellees argue that the letter is not covered by the statute. Although the appellees' arguments are not without some force, we hold that the November 18 letter was a tender offer and that Smallwood may allege violations of Section 14(e) in connection with it.

Neither Congress nor the Commission has provided a definition of the term "tender offer", and the commentators have not reached a concensus. There is general agreement that a tender offer involves a public invitation to a corporation's shareholders to purchase their stock for a specified consideration,[21] and there is some common recognition of typical ingre-

right of action may be inferred from Section 14(e). Not only do we thereby follow the overwhelming weight of authority, but we reaffirm the importance of private litigation to the effective enforcement of the securities laws. See J. I. Case Co. v. Borak, *supra*, 377 U.S. at 432; Chris-Craft Industries, Inc. v. Piper Aircraft Corp., *supra*, 480 F.2d at 361; Herpich v. Wallace, 5 Cir. 1970, 430 F.2d 792, 804.

21. See E. Aranow & H. Einhorn, *supra*, note 20, at 70; Note, The Developing Meaning of "Tender Offer" under the Securities Exchange Act of 1934, 86 Harv.L.Rev. 1250, 1251.

dients in transactions generally accepted to be tender offers.[22] But there is no clear agreement whether, as the appellees here

22. In conventional tender offers the offeror typically offers to purchase all or a portion of a company's shares at a premium price, the offer to remain open for a limited time. Frequently, the obligation to purchase on the part of the offeror is conditioned on the aggregate number of shares tendered: if more than a certain number are tendered, the offeror need not purchase the excess; if less than a certain number are tendered, the offeror need not purchase any. The shareholder responding to the offer generally must relinquish control of the shares he desires to tender until the response of others is determined. H.R.Rep.No.1711, 90th Cong., 2d Sess., 1968 U.S.Code Cong. & Admin.News, p. 2811; S.Rep.No.550, 90th Cong., 1st Sess. 2 (1967); Note, *supra*, note 21, at 1251–1252. These ingredients of typical tender offers are not requirements. The SEC, for example, has stated its intent to extend the coverage of the Williams Act to special bids. SEC Securities Exchange Act of 1934 Release No. 8392 (Aug. 30, 1968). A special bid is a procedure whereby a purchaser makes a public offer to buy a specified number of shares at a fixed price, usually a premium. Shares are then purchased at that amount until the number of shares desired is obtained or until the bid is withdrawn. See Note, *supra*, at 1261. While similar to the conventional tender offer, special bid purchases are not conditioned on the tendering of a certain number of shares, and, instead of relinquishing control of their shares for a period before sale, shareholders can sell their shares immediately upon tender. In Cattlemen's Investment Co. v. Fears, W.D.Okl.1972, 343 F.Supp. 1248, vacated per stipulation, Civil No. 72–152 W.D.Okl., May 8, 1972, the court treated a large-scale program of negotiated purchases as a tender offer under Section 14(e), despite the following facts: (1) no minimum number of shares was required to be tendered before the offeror would purchase, and the tendering shareholder, therefore, faced no period of relinquished control prior to actual sale; (2) no maximum number of shares to be purchased was ever formally announced; and (3) no price was specified in advance. See Note, *supra*, at 1264–1265 n. 74.

Southdown's letter of November 18, 1969, contained more of the ingredients typically found in conventional tender offers than did either the purchase program in *Cattlemen's* or the offers to purchase which were the subject of the SEC release on special bids. Southdown's letter offered all Pearl shareholders a premium price of $45 a share for up to 45 percent of their stock for a total of 653,164 shares. Tendering shareholders were required to deposit their shares with exchange agents until the merger was consummated. And there was a risk that the shares would be returned unsold to the tendering shareholders. Of the typical ingredients mentioned above, the only one lacking was the condition that the offeror need not purchase any shares if a specified number of shares were not tendered.

maintain, a tender offer must be a "hostile bid *opposed* by incumbent management".[23]

[21] The district court seemed to adopt the appellees' approach by holding Section 14(e) inapplicable because Southdown's November 18 letter to the Pearl shareholders was not a "takeover bid". There is some basis in the legislative history for this construction of the Act. In the early and mid-1960's the growth of the public bid to shareholders as a takeover device was alarming.[24] It is clear that the immediate purpose of the Williams Act was to protect investors from unscrupulous corporate raiders who could force shareholders into making a hasty, uninformed decision to sell by offering to buy a portion of the target corporation's securities at a premium price.[25] If the shareholder responded quickly to the offer, he might not learn in time the true risks of his decision, but if he waited, he might lose his opportunity to gain a premium price for his securities because others had already tendered to the offeror the number of shares it required. See

23. Brief of Appellees 10. Compare E. Aranow & H. Einhorn, *supra*, note 20, and Note, *supra*, note 21, with Young, Judicial Enforcement of the Williams Amendments: the Need to Separate the Questions of Violation and Relief, 27 The Business Lawyer 391–92 (Jan. 1972).

24. E. Aranow & H. Einhorn, *supra*, note 20, at 65 & n. 13. Cash tender offers involving companies listed on national securities exchanges rose from eight in 1960 to 107 in 1966. Id., citing 111 Cong.Rec. 24662–64 (Aug. 30, 1967). From 1959 to 1962 outsiders employed the tender offer as a takeover device only 29 times, compared with 41 proxy contests. But from 1963 to 1966 the tender offer was almost twice as popular as the proxy contest as a takeover tool. Note, *supra*, note 21, at 1253 n. 16.

25. See Susquehanna Corp. v. Pan American Sulphur Co., 5 Cir. 1970, 423 F.2d 1075, 1085.

"This provision would affirm the fact that persons engaged in making or opposing tender offers or otherwise seeking to influence the decision of investors or the outcome of the tender offer are under an obligation to make full disclosure of material information to those with whom they deal."

H.R.Rep.No.1711, 90th Cong., 2d Sess., 1968, U.S.Code Cong. & Admin.News, p. 2821. See also Electronic Specialty Co. v. International Controls Corp., 2 Cir. 1969, 409 F.2d 937, 945.

H.R.Rep.No.1711, 90th Cong., 2d Sess., 1968 U.S.Code Cong. & Admin.News, p. 2812.

[22–25] That takeover bids formed the immediate catalyst to precipitate the Williams Act, however, does not require us to so restrict the definition of "tender offer". First, we consider that the failure of Congress and the SEC to define "tender offer" was not inadvertent. On the contrary, it appears that the full meaning of the term was intentionally left to be developed on a case-by-case basis. Neither Congress nor the Commission was reticent in defining the terms of the Williams Act when they chose to do so.[26] Second, we must interpret the securities laws so as to effectuate their broad remedial purposes. Tcherepnin v. Knight, 1967, 389 U.S. 332, 336, 88 S.Ct. 548, 19 L.Ed.2d 564; Herpich v. Wallace, 5 Cir. 1970, 430 F.2d 792, 802. As we have already stated, the Williams Act was intended primarily to aid investor decision-making. To that end, Congress recognized that protection from outsiders is not sufficient; Section 14(e) applies to statements by management of the target company, as well as by the tender offeror. See H.R.Rep.No.1711, 90th Cong., 2d Sess., 1968 Code Cong. & Admin.News, p. 2821. Moreover, if there is danger that an investor may be misled by management of the target company or the tender offeror in a situation where these two are hostile, there is no reason to assume that the danger will be lessened when both are on the same side of the fence.[27] Indeed, investors would seem to require greater protection in this situation. Cf. Electronic

26. See 15 U.S.C. § 78n(d)(2) & (3); 17 C.F.R. § 240.14a–1.

27. Citing Schoenbaum v. Firstbrook, 2 Cir. 1968, 405 F.2d 215, cert. denied, 395 U.S. 906, 89 S.Ct. 1747, 23 L.Ed.2d 219, and Dasho v. Susquehanna Corp., 7 Cir. 1972, 461 F.2d 11, the appellees also contend that there can be no Section 14(e) or Rule 10b–5 liability in this case because the transactions were "arms-length". Those cases are inapposite. In both *Schoenbaum* and *Dasho* the controlling fact was that the transactions in question did not require shareholder approval. Neither case purports to speak to a situation where the plaintiff alleges fraud by the Board of Directors in transactions involving shareholder decision-making.

Specialty Co. v. International Controls Corp., 2 Cir. 1969, 409 F.2d 937, 946. Finally, in the Williams Act Congress itself seemed to envision friendly tender offers: Section 14(d)(8) exempts tender offers "by the issuer of such securities" from certain filing requirements. 15 U.S.C. § 78n(d)(8). We hold, therefore, that a bid to purchase securities is no less a "tender offer" within the meaning of Section 14(e) when it is unopposed by management of the target company than when it is opposed.

The appellees cite us to Dyer v. Eastern Trust & Banking Co., D.Me.1971, 336 F.Supp. 890. We do not quarrel with the substance of that holding. In *Dyer* Judge Gignoux refused to extend the coverage of Section 14(e) to a two-step corporate reorganization involving a merger and exchange of stock. The individual defendants had established Northeastern Bankshares Association, a bank holding company, which in turn had established Kenduskeag Banking Company, a "phantom bank" never intended to carry on banking business. Eastern merged with Kenduskeag, Eastern surviving. Then each Eastern shareholder who did not dissent exchanged his shares for shares of Northeastern. After the transactions were completed, Eastern was owned by Northeastern, and the past shareholders of the former owned the latter corporation. In effect, the transactions did no more than interpose a bank holding company, Northeastern, between Eastern and its shareholders. There was no real change in ownership and control. As the court found, no more was involved than "a change in corporate structure". 336 F.Supp. at 909.

[26] The lesson we read in *Dyer* is not that there may not be a friendly tender offer. Rather, it is that a corporation does not become a tender offeror simply by proposing a paper exchange of securities. There must be contemplated some change of control. If actual control does not shift, it is difficult to see why the shareholder needs the protection of Section 14(e). He has what he had before, in reality if not in

form. He has made no significant investment decision for which information and reflection are essential. He has not been "forced to take a chance". H.R.Rep.No.1711, 90th Cong., 2d Sess., 1968 U.S.Code Cong. & Admin.News p. 2812. In contrast to the the situation in *Dyer*, Southdown's letter of November 18, 1969, required Pearl's shareholders to make an important and irrevocable investment decision—to sell or not to sell for $45 each the shares of Southdown preferred due them upon consummation of the merger.

[27] The appellees make a final argument against the applicability of Section 14(e) by attempting to separate the offer from the purchase of the securities tendered pursuant to the November 18 letter. The argument appears to run like this: A "tender offer" under the Williams Act must include an offer *to purchase* securities. Neither Southdown nor Pearl was "purchasing" securities, and, although Zapata made the ultimate purchase, it did not make a "tender offer for, or request or invitation for tenders of, any class of equity security"; Zapata was not considered as a potential purchaser on November 18. We know of no requirement in Section 14(e), however, that the person or company inviting the tenders makes the ultimate purchase. Furthermore, we cannot believe that Congress contemplated that the statute could be so easily circumvented. Whether the tender offeror purchases the securities or simply invites a tender for another is of no account to the investor for whose protection Section 14(e) was enacted. A "tender" offer within the meaning of the Williams Act may be made by those acting in concert with others as well as those acting alone.[28]

28. Smallwood also alleges violations of Section 14(a) of the Securities Exchange Act and Rules 14a-3(a) and 14a-9(a) thereunder. The appellees do not argue that Smallwood may not sue under Section 14(a), and indeed there is no question. See, e. g., Greater Iowa Corp. v. McLendon, 8 Cir. 1967, 378 F.2d 783; Studebaker Corp. v. Gittlin, 2 Cir. 1966, 360 F.2d 692; Dann v. Studebaker-Packard Corp., 6 Cir. 1961, 288 F.2d 201.

III.

LIABILITY

A. *Pearl's letter of July 17, 1969*—Turning to the question whether Smallwood actually proved at trial that the defendants violated the securities laws, chronologically the first contested action we encounter is Pearl's letter of July 17, 1969.

Executive Vice President Range mailed a press release and cover letter to Pearl shareholders on July 17 advising them that the Boards of Directors of Pearl and Southdown had approved a merger agreement between the two companies and describing some of its more significant provisions. The correspondence was not accompanied by a proxy statement. Smallwood maintains that the letter violated Rule 14a–3(a) of the Securities Exchange Act of 1934, 17 C.F.R. § 240.14a–3(a), which prohibits soliciting proxies without furnishing a written proxy statement.

Rule 14a–1(f) broadly defines "solicit" and "solicitation" to include:

> "(i) Any request for a proxy whether or not accompanied by or included in a form of proxy;
>
> (ii) Any request to execute or not to execute, or to revoke, a proxy; or
>
> (iii) The furnishing of a form of proxy or other communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy."

17 C.F.R. 240.14a–1(f).

[28] Pearl's July 17 correspondence was not a "request for a proxy" or a "request to execute or not to execute, or to revoke, a proxy" under Rule 14a–1(f). Proxies were not mentioned in either the letter or the press release. Moreover, a date for the stockholders meeting at which the merger

would be voted on had not been established and was in any event apparently contingent upon the approval of the merger by Southdown's shareholders. We recognize, however, that even a communication well in advance of any formal request for a proxy may be made "under circumstances reasonably calculated to result in the procurement, withholding, or revocation of a proxy" and thus may be considered a "solicitation" within the Proxy Rules. Furthermore, a letter not itself requesting proxies may be subject to the Proxy Rules as "part of a continuous plan ending in solicitation . . . which prepare[s] the way for its success". S. E. C. v. Okin, 2 Cir. 1943, 132 F.2d 784, 786.

There are sound reasons for limiting the ability of interested parties to color the issue prior to the disclosure of complete information as required in a proxy statement. Without some restrictions, seeds of argument could be planted so deeply and securely prior to the time of formal proxy solicitation as to resist effectively later uprooting. As Judge Learned Hand stated in *Okin*: "We have no doubt that the power [of the SEC to regulate] extends to such writings; were it not so, an easy way would be open to circumvent the statute; one need only spread the misinformation adequately before beginning to solicit, and the Commission would be powerless to protect shareholders. The earlier stages in the execution of such a continuous purpose must be subject to regulation, if the purpose of Congress is to be fully carried out." 132 F.2d at 786.

[29] There are, however, countervailing considerations. It seems clear that we cannot always expect both prompt and complete disclosure of material corporate developments. The information required in a proxy statement is extensive, see Schedule 14A, 17 C.F.R. § 240.14a–101, and care is needed in its preparation.[29] And there is some value to encouraging

29. Furthermore, gathering the information required in a proxy statement is likely to be so expensive that even the most primitive cost/benefit analysis would militate against requiring that all corpo-

prompt disclosure. Prompt disclosure helps to ensure not only that all investors, insiders and outsiders, have at all times equal access to market information, see S. E. C. v. Texas Gulf Sulphur Co., 2 Cir. 1968, 401 F.2d 833 (en banc), cert. denied sub nom., Coates v. S. E. C. & S. E. C. v. Kline, 394 U.S. 976, 89 S.Ct. 1454, 22 L.Ed.2d 756, but also that investors are provided a continuing opportunity to make "knowing, intelligent decisions", Herpich v. Wallace, 5 Cir. 1970, 430 F.2d 792, 806; Kahan v. Rosenstiel, 3 Cir. 1970, 424 F.2d 161, 173, cert. denied, 398 U.S. 950, 90 S.Ct. 1870, 26 L.Ed.2d 290. We do not believe that Congress intended to sacrifice utterly the speed of disclosure to ensure its completeness. Thus we seek not to discourage the expeditious reporting of significant developments which may affect the price of a corporation's stock. While we cannot overlook the capacity of such a communication to affect later shareholder voting, it is reasonable to conclude that statements describing an event that has just occurred should be examined under a less powerful glass than similar statements made after a period sufficient for careful study and reflection has passed.

It is important also to know whether, when the questionable statement is made, proxies have been requested or the time for soliciting proxies is near. In general, the further removed the statement is from an act of shareholder suffrage, the less likely it is that the statement will leave its imprint upon that

rate announcements with a possibility of affecting some future proxy solicitation be accompanied or preceded by the information contained in a proxy statement. "Free and open disclosure" holds a clarion ring, but we must remember that freely flowing information is not an end in itself; it is the means by which we reaffirm our belief that informed shareholders, making decisions they consider to be in their own best interests, will in the aggregate guide the economy along the optimum route. With too little information shareholders cannot effectively translate their desires into corporate decision-making, but requiring the gathering and dissemination of too much information will hang as a heavy weight around the neck of the securities market. Cf. Dooley, The Effects of Civil Liability on Investment Banking and the New Issues Market, 58 Va.L.Rev. 776, 835.

shareholder action. See Brown v. Chicago Rock Island & Pacific RR. Co., 7 Cir. 1964, 328 F.2d 122, 125.

[30] We hold that, taking into consideration these factors, the July 17 letter was not "reasonably calculated to result in the procurement . . . of a proxy". The correspondence was sent within a week of the agreement to merge. No proxies were mentioned in the communication, and as of July 17 no stockholders meeting had been called and no proxies had been requested. See Brown v. Chicago Rock Island & Pacific RR. Co., *supra*, at 125. Compare Union Pacific RR. Co. v. Chicago Northwest Ry. Co., N.D.Ill.1964, 226 F.Supp. 400. Moreover, the correspondence, if not totally innocuous, was not overwhelmingly prejudicial either. The press release merely stated that a merger proposal had been approved and detailed some of the provisions. The cover letter stated that the Boards of Pearl and Southdown believed the merger "to be in the best interest of the shareholders of both companies" and that the Boards recommended that the merger be approved. To say that the directors approved the merger agreement because they thought the merger to be in the shareholders' interest is to say only that the directors did their fiduciary duty. And one would only expect that having themselves approved the agreement they would recommend that the shareholders approve it in turn. In these circumstances we conclude that the correspondence did not violate Rule 14a–3(a).

[31] B. *The Proxy Materials of August 12, 1969*—The jury findings failed to substantiate Smallwood's complaint that the proxy materials of August 12, 1969, violated any of the federal securities laws. Smallwood contends on appeal that, as a matter of law, the proxy statement violated Rule 14a–9(a) of the Securities Exchange Act of 1934, 17 C.F.R. § 240.14a–9(a), which prohibits misleading statements and omissions in proxy materials. He argues that the August 12 communication contains omissions of material facts, in that Pearl's power to waive Southdown's obligation to obtain an

underwriting commitment was inadequately disclosed, and Albert Range's stock option was not disclosed at all.

[32–34] 1. *Disclosure of the Waiver Power*—The merger agreement conditioned Pearl's obligation to consummate the merger on the fulfillment "(or waiver by Pearl in writing)" of Southdown's obligation to procure a firm commitment from a group of underwriters to purchase for a period of ten days following the merger up to 45 percent of the shares of Southdown preferred stock for $45 a share from those shareholders who desired to sell. The merger agreement was attached as Appendix II to the proxy statement of August 12. Although Southdown's obligation to arrange for a firm commitment underwriting was mentioned three other times in the materials sent to the Pearl shareholders on August 12, the waiver power was mentioned only in the merger agreement. Nevertheless, the proxy materials, in the first sentence of the first page and several other times, referred the reader to the merger agreement. The jury found that the waiver power was adequately disclosed.[30]

30. Special Issue No. 9 read as follows:
"Do you find from a preponderance of the evidence that Pearl's August 12, 1969 proxy statement failed to adequately disclose that the Board of Directors of Pearl had the power to waive the condition of Pearl's obligation to consummate the merger by obtaining a firm commitment from a group of underwriters to purchase up to 45% of the Southdown preferred stock at a price of $45 per share for a period of 10 days following the effective date of the merger?"
The jury answered "No".
On February 2, 1972, one of Smallwood's attorneys submitted an affidavit to the district court to the effect that, after the jury's verdict was returned, he received a telephone call from a Mr. Brooks, one of the jurors, and that during their conversation Mr. Brooks indicated that the jury had intended to convey its opinion that the waiver power had *not* been adequately disclosed. Meeting with counsel for the plaintiff and defendants, at the behest of plaintiff's attorneys the court forbade counsel for both sides to talk with any of the jurors. On the plaintiff's motion, the court reimpaneled the jury on February 15, 1972. After reading Special Issue No. 9 to the jury, the court asked, "Did the jury unanimously vote to answer that issue 'No'?" Polled individually, each juror told the court that he voted to answer the issue "No". The court then

There is no dispute that both by position in the proxy materials and by weight of repetition Southdown's obligation to obtain an underwriting commitment gained prominence over the power to waive that provision. And the general references to the merger agreement did not completely counter-balance this effect. Nevertheless, we consider that the balance was not tipped so sharply as to require that we override the jury's finding.

[35] We have already stated that the information required in a proxy statement is extensive. Difficult decisions must be made as to what information to place toward the beginning and what to place further toward the end of proxy statements, what to emphasize and what to state more blandly. It is, of course, impossible to emphasize everything, and every fact cannot be contained in the beginning. DiJulio v. Digicon, Inc., D.Md.1972, 339 F.Supp. 1284, 1290. We require those who draw up proxy statements to be fair and sensitive to the needs of shareholders in exercising their rights of corporate

overruled Smallwood's motion to correct the verdict and reinstructed Smallwood's counsel not to speak to the jury.

But the matter was not yet concluded. On March 23, 1972, Smallwood filed a motion for leave to obtain juror affidavits. Two of his attorneys stated by affidavit that on leaving the courtroom on February 15, 1972, several of the jurors had approached them, stating that they had conferred and were in agreement that the jury verdict was that the waiver power was *not* adequately disclosed. The motion for leave to obtain juror's affidavits was denied.

Smallwood contends that the jury was confused by the double-negative aspect of Special Issue No. 9 caused by the presence of the word "failed". Special Issue No. 9, however, was virtually identical to the special issue Smallwood had requested. It would seem contrary to any concept of judicial economy to provide him a second bite of the apple when any responsibility for confusing the jury must fall at his own door. Cf. Safeway Stores, Inc. v. Dial, 5 Cir. 1963, 311 F.2d 595. In any event, we find that taking jurors' affidavits in this instance would violate the well-established principle that jurors may not impeach their verdict. See McDonald v. Pless, 1915, 238 U.S. 264, 267–268, 35 S.Ct. 783, 59 L.Ed. 1300; Complete Auto Transit, Inc. v. Wayne Broyles Engineering Corp., 5 Cir. 1965, 351 F.2d 478, 480. Whether or not the jury misunderstood the charge of the court is not a question to be reexamined after the verdict has been rendered. United States v. Chereton, 6 Cir. 1962, 309 F.2d 197.

suffrage. But we do not require that the writers of proxy statements be clairvoyant. A fact essential for a shareholder decision today may become irrelevant tomorrow, and vice versa. It is enough that proxy statements be complete and not misleading in light of the circumstances existent and reasonably anticipated at the time distributed.[31] See Rule 14a–5, 17 C.F.R. § 240.14a–5; Miller v. Steinbach, S.D.N.Y. 1967, 268 F.Supp. 255, 276.

Smallwood failed to produce any evidence at trial that as of August 12, 1969, the defendants anticipated, or should have anticipated, that Southdown would be unable to obtain an underwriting commitment pursuant to the merger agreement. The uncontradicted testimony was that Pearl's attorney, Guenther, sought and received confirmation from Lehman Brothers before the merger agreement was signed that such a firm commitment was possible. Moreover, Lehman Brothers was prepared, at least into November 1969, to go through with the underwriting. We find that there was ample evidence for the jury to find that considering the totality of circumstances the waiver power was adequately disclosed.

The doctrines of "buried facts" and "similar emphasis" do not compel a different result. See Swanson v. American Consumer Industries, Inc., 7 Cir. 1969, 415 F.2d 1326, 1330; Mills v. Electric Auto-Lite Co., 7 Cir. 1968, 403 F.2d 429, 433–434, vacated on other grounds, 1970, 396 U.S. 375, 90 S.Ct. 616, 24 L.Ed.2d 593; Gould v. American Hawaiian Steamship Co., D.Del.1971, 331 F.Supp. 981, 995; Kohn v. American Metal Climax, Inc., D.D.Pa.1970, 322 F.Supp. 1331, 1362, modified on other grounds, 3 Cir. 1971, 458 F.2d 255, 265, cert. denied, 409 U.S. 874, 93 S.Ct. 120, 34 L.Ed.2d 126; Beatty v.

31. In Gerstle v. Gamble-Skogmo, Inc., 2 Cir. 1973, 478 F.2d 1281, 1300–1301, the Court held that scienter is not an element of proof under Rule 14a-9 in a case where the plaintiffs "represent the very class who were asked to approve a merger on the basis of a misleading proxy statement". We need not broach the issue; the standard outlined here is implicit even if negligence is taken as the test of culpability.

Bright, S.D.Iowa, 1970, 318 F.Supp. 169, 174; Norte & Co. v. Huffines, S.D.N.Y.1968, 304 F.Supp. 1096, 1110, aff'd in part, remanded in part, on other grounds, 2 Cir. 1969, 416 F.2d 1189, cert. denied, 397 U.S. 989, 90 S.Ct. 1121, 25 L.Ed.2d 396. In each of these cases the facts held to be inadequately disclosed—predominantly concerning conflicts of interest—were apparent at the time the proxy materials were mailed, and it should have been obvious at that time that burying the facts, or giving them less than significant emphasis, would deprive the shareholders of "full and honest disclosure", Greater Iowa Corp. v. McLendon, 8 Cir. 1967, 378 F.2d 783, 795.

[36] We base our holding on the lack of evidence that anyone should reasonably have anticipated that the waiver provision would be material to the shareholder's decision to approve or disapprove the merger. We do not fear, therefore, that we are traversing a slippery slope where "management can come to the shareholders for approval of an offer that has certain irresistable features, obtain approval largely on the basis of those features, and then eliminate them by use of the blank check or waiver power the shareholders have given them."[32] The position and emphasis given in a proxy statement to waiver powers invoked for any cause reasonably to be anticipated at the time a proxy statement is distributed deserves close judicial scrutiny.

2. *Materiality of Range's Stock Option*—The jury found that during the merger negotiations in the Spring of 1969 D. Doyle Mize, Chairman of the Board of Southdown, agreed that Southdown would give Albert Range a qualified stock option to purchase 25,000 shares of Southdown common stock should the merger between Southdown and Pearl be consummated. The proxy statement did not mention the promise of such an option. The jury found that the failure to disclose the stock option was *not* an omission of a material fact.

32. Brief of Appellant 44.

[37] Smallwood argues first that in its charge to the jury the district court defined "material" erroneously. The court's test of materiality was "whether a reasonably prudent person *would* attach importance to the information in determining his course of action". (Emphasis supplied.) Smallwood contends that the proper definition of "material" is whether a reasonable shareholder *might* consider the information important in determining how to vote.

A recent decision of this Circuit endorsed a definition almost identical to the one used by the trial court in this instance. In John R. Lewis, Inc. v. Newman, 5 Cir. 1971, 446 F.2d 800, 804, this Court held that the test of materiality is "whether a reasonable man would attach importance to the fact misrepresented in determining his course of action". This definition, born of the Restatement of Torts, § 538(2)(a), has a rich history of application to the securities laws. See, e. g., Chris-Craft Industries, Inc. v. Piper Aircraft Corp., 2 Cir. 1973, 480 F.2d 341, 363; Rogen v. Ilikon Corp., 1 Cir. 1966, 361 F.2d 260, 266; List v. Fashion Park, Inc., 2 Cir. 1965, 340 F.2d 457, 462, cert. denied, 382 U.S. 811, 86 S.Ct. 23, 15 L.Ed.2d 60. It has not been and should not be discarded as a standard. See ALI, Federal Securities Code § 256 (Tent. Draft No. 2, March 1973).

The appellant points out that the phraseology used by the Supreme Court in Mills v. Electric Auto-Lite Co., 1970, 396 U.S. 375, 384, 90 S.Ct. 616, 24 L.Ed.2d 593, and Affiliated Ute Citizens v. United States, 1972, 406 U.S. 128, 153–154, 92 S.Ct. 1456, 31 L.Ed.2d 741, was whether a fact *might* have been considered important by a reasonable investor. We are not convinced, however, that the Court intended to replace the traditional standard with a more relaxed one. There is no evidence of any desire by the Court to relax the standard of materiality to a mere possibility of influence upon a reasonable investor, a standard implied by the word "might". On the contrary, the Court in *Mills* emphasized that the test of materiality required "a significant *propensity* to affect the

voting process", 396 U.S. at 384 (emphasis original). Moreover, the word "might" does not seem to have been carefully considered by the Court. See the thorough discussion by Judge Friendly on this point in Gerstle v. Gamble-Skogmo, Inc., 2 Cir. 1973, 478 F.2d 1281, 1301–1302. No issue of materiality was presented on appeal in *Mills*, and Justice Harlan was not seeking to describe a standard when he said: "Where the misstatement or omission in a proxy statement has been shown to be 'material,' as it was found to be here, that determination itself indubitably embodies a conclusion that the defect was of such a character that it might have been considered important by a reasonable shareholder who was in the process of deciding how to vote." 396 U.S. at 384. Rather, he was characterizing "the minimum that all would agree was 'embodied' in the district court's conclusion that the defect was material". Gerstle v. Gamble-Skogmo, Inc., *supra*, 478 F.2d at 1301. And as support for the statement Justice Harlan cited the standard of the Restatement. The Court in *Ute* adopted the word "might" without comment.

[38] Smallwood also charges that the district court erred by not finding the stock option material as a matter of law. But the stock option appears not "so obviously important to an investor, that reasonable minds cannot differ on the question of materiality". Johns Hopkins University v. Hutton, 4 Cir. 1970, 422 F.2d 1124, 1129. Certainly, it is essential that the recipients of a proxy statement know that a director's recommendation contained therein is not completely disinterested. See Mills v. Electric Auto-Lite Co., 7 Cir. 1968, 403 F.2d 429, vacated on other grounds, 1970, 396 U.S. 375, 90 S.Ct. 616, 24 L.Ed.2d 593; Swanson v. American Consumer Industries, Inc., 7 Cir. 1969, 415 F.2d 1326. But the proxy materials of August 12, 1969, made it clear that Range would have some personal gain from the consummation of the merger. The materials indicated that Range was to become a director of Southdown, that he was to be employed under a written contract for $75,000 annually, and that Southdown had a

qualified stock option plan. Although the Pearl shareholders were not advised of the full extent of the merger's possible value to Range, they were "sufficiently alerted" to Range's interests "to be on their guard". Mills v. Electric Auto-lite Co., *supra*, 403 F.2d at 434. We do not imply that the stock option was not of sufficient importance to support a jury finding of materiality. Clearly, it was. We hold only that the question of the materiality of the option was within the legitimate province of the jury.

C. *The letter of November 18, 1969*—On November 18, 1969, Southdown sent to Pearl's shareholders a cover letter with attachments to instruct the shareholders in the procedures necessary for them to sell their Southdown preferred stock to underwriters for $45 a share. The letter assumed that a firm commitment underwriting would be accomplished and that all other conditions to the merger would be met. To sell their Southdown preferred to the underwriters, the letter instructed, Pearl's shareholders must tender their certificates of Pearl stock, with the appropriate deposit form, to appointed exchange agents by 3:30 P.M. on December 2, 1969. Nowhere did the November 18 materials contain mention of the waiver power, and the instructions precluded any possibility that Pearl's shareholders would be permitted to tender their shares of Southdown preferred to underwriters under the merger agreement for ten days following the consummation of the merger.

The jury found that the November 18 letter omitted the following material facts: (1) that the December 2 deadline for tendering shares was a change from the terms of the merger agreement, (2) that the merger could be consummated without an underwriting agreement and without a ten-day period after the merger in which to tender shares, (3) and that a corporation with a substantial investment in Southdown could be substituted for the underwriters. The jury also found that the first two of these omissions, together with the failure to inform the Pearl shareholders that Zapata had a substantial

ownership interest in Southdown, were "act[s], practice[s], or course[s] of business which operated as a fraud or deceit upon the Pearl shareholders in connection with the Pearl-Southdown merger". Smallwood maintains that the trial court erred by not ruling that the defendants violated Section 14(e) and Rule 10b–5. We disagree.

[39] We are in accord with the Second Circuit that the same elements must be proved to establish a violation of either the Section or the Rule. Chris-Craft Industries, Inc. v. Piper Aircraft Corp., 2 Cir. 1973, 480 F.2d 341, 362. Congress adopted in Section 14(e) the substantive language of the second paragraph of Rule 10b–5 and in so doing accepted the precedential baggage those words have carried over the years. See Electronic Specialty Co. v. International Controls Corp., 2 Cir. 1969, 409 F.2d 937, 945. Once standing is established, therefore, the analysis under Section 14(e) and Rule 10b–5 is identical. Thus we consider together Smallwood's contentions that the November 18 letter violated Section 14(e) and Rule 10b–5.

[40, 41] Before discussing why we affirm the district court's holding that Smallwood has not established a right of recovery concerning the November 18 letter, it is important to put to rest one of the appellees' arguments on which we do not rely; that is, that the disclosure in the proxy materials of the power of the Pearl Board to waive the underwriting commitment immunized a lack of similar disclosure in the November 18 letter. We cannot accept the premise that prior disclosure in one communication will automatically excuse omissions in another. As we indicated above, the adequacy of disclosure is a function of position, emphasis, and the reasonable anticipation that certain future events will occur. Perception of future events may take on a different cast as the future approaches, and, what is more important, later correspondence may act to bury facts previously disclosed. A balance once struck will not ensure a balance on the future. As new communications add a dash of recommendation, a

pinch of promise, and a dusting of repetition, the scale may be tipped. To prevent an injustice to the shareholders, the elements must be weighed each time that the shareholders are requested (or encouraged) to make a new decision. See Chris-Craft Industries, Inc. v. Piper Aircraft Corp., *supra*, 480 F.2d at 365 n. 18.

We do not imply that previously disclosed facts may not be considered in the balance. Nor do we imply that a material fact must be disclosed in each communication or be repeated before each shareholder decision in order to avoid a violation of the securities laws. Facts may be adequately disclosed by emphasis or repetitions in previous correspondence by the same parties or through outside sources. In Johnson v. Wiggs, 5 Cir. 1971, 443 F.2d 803, for example, this Court held that information reported in the newspapers and on television and readily available in any brokerage house was sufficiently "in the public domain"; the defendant did not need to disclose "that which had been publicly proclaimed in several ways on several occasions". Id. at 806. Nevertheless, we emphasize that the adequacy of disclosure can be measured only by considering the total mix.

[42] It is not clear whether in its findings concerning the November 18 correspondence the jury considered, as it should have, the disclosure of the waiver power in the August 12 proxy materials. But we need not attempt to interpret the findings or remand for clarification. For even if we assume that the jury found that, taking into account all of the correspondence, the November 18 letter contained omissions of material facts, Smallwood failed to establish that the defendants acted with any culpability.

[43] Some culpability has consistently been required as an element of proof in this Circuit in cases alleging violations of Rule 10b–5. See, e. g., Herpich v. Wallace, 5 Cir. 1970, 430 F.2d 792, 804; Clement A. Evans & Co. v. McAlpine, 5 Cir. 1970, 434 F.2d 100, 103, cert. denied, 402 U.S. 988, 91 S.Ct. 1660, 29 L.Ed.2d 153. And we reiterate that the elements to

be proved to establish a violation of Section 14(e) are identical to those under the Rule. There is no question of requiring plaintiffs to prove scienter in its strict common law sense—that the defendants made statements they either knew to be false or knew they had no basis for believing were true. See Derry v. Peel, House of Lords 1889, 14 App.Cas. 337, 374. The trend in the federal courts has been toward a more relaxed test. See, e. g., Stevens v. Vowell, 10 Cir. 1965, 343 F.2d 374, 379 (common law fraud not required); S. E. C. v. Texas Gulf Sulphur Co., 2 Cir. 1968, 401 F.2d 833, 854 (en banc), cert. denied, sub nom., Coates v. S. E. C. & S. E. C. v. Kline, 394 U.S. 976, 89 S.Ct. 1454, 22 L.Ed.2d 756 (specific intent to defraud not required); City National Bank v. Vanderboom, 8 Cir. 1970, 422 F.2d 221, 229, cert. denied, 399 U.S. 905, 90 S.Ct. 2196, 26 L.Ed.2d 560 (knowledge of impression made not required); Kohler v. Kohler Co., 7 Cir. 1963, 319 F.2d 634, 637 (knowledge of falsity and bad faith intent to mislead not required). Some Courts have gone so far as to state, or hint, that they were abandoning the fraud requirement under Rule 10b–5.[33] Nevertheless, liability in a private action for damages has apparently never been imposed for negligent conduct under the Rule. See Bucklo, Scienter and Rule 10b–5, 67 Nw.U.L.Rev. 562. With scienter requirements in a state of flux in the Courts of Appeals, we do not view this as the proper occasion to draw the bottom line on the degree of scienter required in this Circuit. Suffice it to say that some culpability, beyond mere negligence, is required.

[44] Smallwood did not demand a special issue on the culpability of the defendants, and no such issue was submitted to the jury. Under Rule 49(a), F.R.Civ.P., the issue is deemed found in accord with the judgment for the defendants below. General Insurance Co. of America v. Fleeger, 5 Cir. 1968, 389

33. See, e. g., Ellis v. Carter, 9 Cir. 1961, 291 F.2d 270; Kohler v. Kohler Co., 7 Cir. 1963, 319 F.2d 634; Myzel v. Fields, 8 Cir. 1967, 386 F.2d 718, cert. denied, 390 U.S. 951, 88 S.Ct. 1043, 19 L.Ed.2d 1143; Stevens v. Vowell, 10 Cir. 1965, 343 F.2d 374.

F.2d 159, 162–163; L'Urbaine Et La Seine v. Rodriguez, 5 Cir. 1959, 268 F.2d 1, 4.

We conclude that the evidence does not compel us to override this implied finding of insufficient proof of culpability. On November 18 all parties expected an underwriting to take place. And there was reason to be sanguine. Lehman Brothers had repeatedly advised Pearl's attorneys and Southdown that an underwriting was feasible, and serious discussion with Lehman Brothers continued into December. Moreover, it was not until after November 18 that Southdown common stock began a steep decline. There was of course a possibility, recognized at least by Albert Range, that the price of Southdown common would sink to the point where an underwriting could not be obtained. But we do not view the evidence as establishing that this possibility loomed so large that the failure to indicate in the November 18 letter the potential consequences should an underwriting not take place was, as a matter of law, more than negligence. Nor is culpability proved by the failure to disclose that the December 2 deadline for tendering shares was a change in the terms of the merger agreement or that the merger could be consummated without a ten-day period afterwards in which shares could be tendered. The evidence does not establish that the defendants knew that these provisions "changed" the merger agreement. Indeed, the testimony indicated that it was never intended that the Pearl shareholders have ten days after the merger to tender their shares.

D. *Exercise of the Waiver Power and Consummation of the Merger*—Smallwood contends that Pearl fraudulently waived the underwriting commitment and thereafter fraudulently consummated the merger. Although he concedes that such a power of waiver may be granted to a board of directors, he insists: (1) that the power was fraudulently exercised in this instance and that, because the merger could not be lawfully consummated without a firm commitment underwriting or its proper waiver, the merger itself was

illegal; (2) that the power to waive the underwriting did not include the power to substitute Zapata Norness, a party with an adverse interest, for the underwriters; and (3) that Pearl never exercised a waiver of the right promised the Pearl shareholders to tender their stock within ten days following the merger.

[45] We find no merit in these contentions. As we have already stated, the waiver power was adequately disclosed in the proxy materials distributed on August 12, 1969. In voting for the merger, therefore, the Pearl shareholders gave the power to waive the underwriting commitment to the Board of Directors. There is no evidence that in exercising the waiver power the Board used anything other than sound business judgment. The possibility of an underwriting, still strong in mid November, had disintegrated. The bottom threatened to drop out of the price of Pearl stock which had risen significantly, against the current of a downward flowing market, in anticipation of the planned merger with Southdown. If the merger had been cancelled, the jury found, Pearl stock would have carried a value of $21.80 a share, $16 less than the stock was actually worth after the merger was effectuated.

[46] As to Smallwood's second contention, we fail to see any logic in the bizarre insistence that even if Pearl could waive the underwriting commitment, it could not substitute another purchaser for the underwriters. The concept of waiver is not so restricted. By waiving the underwriting commitment, Pearl permitted the merger to be consummated, and thereby protected the value of Pearl stock by $16. By obtaining another purchaser for the tendered stock at $45 a share, Pearl saved the benefit of their decision to those shareholders who made the election to sell. Furthermore, there is no evidence that Zapata's purchase injured those who, for whatever reason, retained their shares. Once it became impossible to obtain underwriters to purchase the tendered stock at $45 a share, Pearl was not legally obligated to obtain another purchaser. Pearl could have simply waived the commitment,

returned the tendered shares, and consummated the merger. Instead, Pearl honored what it apparently felt was a moral commitment to the shareholders who had tendered their shares pursuant to the sell-out provision of the merger agreement. We do not find fault with Pearl for this.

[47] Smallwood's argument that Pearl did not exercise a written waiver of the alleged right of shareholders to tender their stock within ten days after the merger is likewise without substance. Pearl had, in fact, never promised that its shareholders would have ten days following the merger to tender their shares. The evidence at trial indicated that it was never intended that Pearl shareholders should have such a right, and, indeed, that such a right would be inconsistent with underwriters' requirements that they know in advance of an underwriting how many shares are to be included. Because Pearl never actually promised this right, Pearl did not, of course, have to formally waive it.

IV.

CONCLUSION

Because of our holdings in this case we need not consider questions of reliance, causation, and the appropriate measure of damages. Nor must we dive into the murky waters of Smallwood's contentions that the district court erred in defining the plaintiff's class and in refusing to grant the plaintiff's motion to invalidate requests by former Pearl directors and other shareholders to be excluded from the class. We have considered Smallwood's other contentions, and we find them to be without merit.

Far from reflecting a "clear, persistent, and almost defiant disregard of the securities laws and the rights of Pearl's stockholders",[34] the record in this case shows a corporation, caught in a downward-moving securities market, attempting

34. Reply brief of Appellant 22–23.

to salvage what it could for its shareholders of a deal made in anticipation of less gloomy days. The district court adjudged the defendants not liable for any losses incurred by Smallwood, his corporation, or his class.

This judgment is

Affirmed.

Adm. Office, U.S. Courts—West Publishing Company, Saint Paul, Minn.

United States Court of Appeals

FOR THE FIFTH CIRCUIT

October Term, 1972

No. 72-2342

D. C. Docket No. CA-3-3632-B

JOE L. SMALLWOOD,
Plaintiff-Appellant,

versus

PEARL BREWING COMPANY, SOUTHDOWN, INC., ZAPATA NORNESS, INC., ALBERT J. RANGE, and D. Doyle Mize,
Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Texas

Before WISDOM, DYER and INGRAHAM, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Texas, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed;

It is further ordered that plaintiff-appellant pay to defendants-appellees, the costs on appeal to be taxed by the Clerk of this Court.

Issued as Mandate: February 19, 1974

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS

DALLAS DIVISION

JOE L. SMALLWOOD	)	
	)	
VS	)	CA NO. 3-3632-B
	)	
SOUTHDOWN, INC., et al	)	

CHARGE OF THE COURT

MEMBERS OF THE JURY:

This case involves the merger of Pearl Brewing Company into Southdown, Inc. on December 30, 1969. Joe L. Smallwood for himself and as representative of a class of Pearl shareholders sues Pearl Brewing Company, Southdown, Inc., Zapata-Norness, Albert J. Range, Chief Executive Officer of Pearl, and D. Doyle Mize, Chairman of the Board and Chief Executive Officer of Southdown, Inc.

Smallwood contends that the proxy statement of August 12, 1969 sent by Pearl to all stockholders announcing a meeting on September 9, 1969 to vote on the proposed merger of Pearl with Southdown was misleading in that it failed to contain certain material facts. According to Smallwood the following were not adequately disclosed: (1) That Defendant Range had been given a stock option on 25,000 shares of Southdown common stock, (2) That the condition to the merger of obtaining a firm commitment from a group of underwriters could be waived, (3) That Aztec Oil and Gas Company had made an offer for all of the Pearl stock, which offer had been recommended in preference to Southdown's offer by financial analysts hired by Pearl,

and (4) that Range participated in the negotiations leading up to the merger.

The agreement and plan of merger approved by the stockholders on September 9, 1969 provided that "One of the conditions of Pearl's obligation to consummate is the receipt by Southdown of a firm commitment from a group of underwriters to purchase for a period of 10 days following the effective date of the merger, at a price of $45 net per share, up to 45% of the Southdown preferred stock into which Pearl stock will have been converted". Plaintiff Smallwood contends that this condition is a material condition of Pearl's obligation to consummate the merger. According to Southdown it later became impossible for Southdown to obtain a firm commitment from a group of underwriters. Thereafter Zapata-Norness, which was a major stockholder of Southdown, agreed to take 255,789 shares of the Southdown preferred stock received by Pearl stockholders in exchange for their Pearl common stock. On November 18, 1969 Southdown notified the shareholders of Pearl that it would be necessary for Pearl stockholders who wished to sell to have their certificates for Pearl common stock in the hands of the National Bank of Commerce of San Antonio prior to 3:30 p.m. Eastern Standard Time on December 2, 1969. The purchase by Zapata of the Pearl shares was approved by the Pearl Board of Directors at its meeting on December 22, 1969. It is Plaintiff's contention that the Pearl Directors had no power to make changes in the merger agreement.

Plaintiff Smallwood further contends that the Defendants entered into a conspiracy after the execution of the agreement and plan of merger to cause Pearl Brewing Company to be merged into Southdown on different terms and for a less valuable consideration than Pearl was entitled to insist upon under the provisions of the agreement and plan of merger voted by the stockholders on September 9, 1969.

Plaintiff Smallwood sues for damages directly resulting from

the alleged material omissions from the proxy statement, the alleged material changes by the Board of Pearl in the plan for merger, and an alleged conspiracy of the Defendant to cause Pearl to be merged into Southdown on different terms than under the provisions of the plan of merger voted by the shareholders on September 9, 1969.

All Defendants deny the allegations of Plaintiff's complaint. It is the Defendants' contention that the proxy statement of August 12, 1969 explained in detail the terms and conditions of the proposed merger and was not misleading in that it failed to contain certain material facts.

Defendants specifically deny any conspiracy on their part and contend they acted in good faith.

Defendants contend further that the conditions of Pearl's obligation to consummate the merger could be waived and the decisions of the Pearl Board changing the terms of the merger plan were the result of fair collective business judgment.

You are instructed that the term "adequate disclosure" as used in this charge means full and fair disclosure of a particular fact. In determining whether full and fair disclosure of a particular fact has been made, you may consider the placement in the proxy materials and the emphasis given to the fact which is claimed to have been disclosed as compared with the placement and emphasis of other statements in the proxy statement which would be misleading unless such disclosure is adequate.

By the term "material change" of an agreement as used herein is meant a change of a reasonably important term or provision of such agreement.

By the term "material modification" as used in this charge is meant the elimination of a reasonably important term or provision in a contract and the substitution therefor of a new and substantially different term or provision.

The test of whether a thing represented is "material" is

whether a reasonably prudent person would attach importance to the information in determining his course of action in the transaction in question.

By the term "conspiracy" as used in this charge is meant a combination by two or more persons (the term person includes corporation as well as individuals) to accomplish a lawful purpose by unlawful means, or to accomplish an unlawful purpose by lawful means.

You are instructed that Section 14(e) of the Securities Exchange Act provides:

> "It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation."

Rule 10b-5(2) of the Securities Exchange Act of 1934 provides:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> * * *
>
> "(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading,
>
> * * *
>
> "in connection with the purchase or sale of any security."

The gist of a civil conspiracy is damage resulting from commission of wrong which injures another and not the conspiracy itself.

One without knowledge of the object and purpose of a con-

spiracy cannot be a co-conspirator; he cannot agree either expressly or tacitly to the commission of a wrong of which he has no knowledge. One of the essential elements of civil conspiracy is a meeting of minds on the object or course of action.

You are instructed that there are two types of evidence. One is direct evidence such as the testimony of any eye witness. The other is circumstantial evidence. The existence of a conspiracy and the connection of a person with such conspiracy may be proved or disproved by circumstantial evidence as well as by direct evidence. The fact may be established by circumstantial evidence when the existence of such fact is fairly and reasonably inferred from other facts proved in the case by direct evidence.

The term "a party to the conspiracy" as used in this charge means and includes any person who agrees or knowingly combines with another person or persons to accomplish the purpose of the conspiracy.

You are further instructed that a representation of facts is relied on by a person if it is a substantial factor in his determination of a course of conduct to be followed by him. An omission of a fact is relied upon within the meaning of this charge if the person to whom such fact was not disclosed would have been influenced to act differently than he did act had such fact been disclosed to him.

By the term "fair market value" is meant the price which property will sell for when offered for sale by a person who is willing to sell but not required to sell to a purchaser who is willing to purchase but who is not required to purchase, where both have reasonable knowledge of the facts.

By the term "ordinary care" as used in this charge is meant that degree of care that would be exercised by a person of ordinary prudence under the same or similar circumstances.

By the term "proximate cause" as used in this charge is

meant that cause which in its natural and continuous sequence produces a result that would not have occurred but for such cause, and which said result or some like result ought reasonably to have been foreseen or anticipated by a person of ordinary prudence in the exercise of ordinary care in the light of the attending circumstances. There may be more than one proximate cause of an event.

By the term "preponderance of the evidence" is meant the greater weight of credible testimony before you.

By the term "credible testimony" is meant that testimony which the Jury deem to be worthy of belief.

Bearing in mind the foregoing definitions and instructions, you will answer the following special issues in accordance with the instructions in connection with each special issue.

SPECIAL ISSUE NO. 1

Do you find from a preponderance of the evidence that in Southdown's November 18, 1969 letter to Pearl shareholders the elimination of the 10-day period after the merger date for tender of 45% of their new Southdown preferred stock pursuant to a firm underwriting commitment was a material change in the merger plan?

Answer "yes" or "no" ANSWER: yes

SPECIAL ISSUE NO. 2

Do you find from a preponderance of the evidence that the December 22, 1969 agreement of the Pearl Board of Directors to accept Zapata-Norness' purchase of the 255,798 shares of new Southdown preferred stock in lieu of the firm underwriting commitment for a period of 10 days following the merger date was a material modification of the agreement and plan of merger which had been approved by the Pearl shareholders on September 9, 1969?

Answer "yes" or "no" ANSWER: yes

If you have answered special issues 1 or 2 "yes", then answer special issue no. 3. Otherwise, do not answer special issue no. 3.

SPECIAL ISSUE NO. 3

Do you find from a preponderance of the evidence that a reasonable Pearl shareholder would have tendered his newly acquired Southdown stock to the underwriters for $45 per share if the merger had been consummated in accordance with the terms originally set forth in the agreement and plan of merger of September 9, 1969?

Answer "yes" or "no" ANSWER: yes

SPECIAL ISSUE NO. 4

What do you find from a preponderance of the evidence would have been the reasonable cash market value of the new Southdown preferred stock at the time of its issuance on December 30, 1969 if the merger had been consummated in accordance with the terms and conditions set forth in the agreement and plan of merger of September 9, 1969?

Answer in dollars, if any, and cents, if any, per share, or none.

ANSWER: $45.00

SPECIAL ISSUE NO. 5

What do you find from a preponderance of the evidence was the reasonable cash market value per share on December 30, 1969 of the new Southdown preferred stock issued under the changed merger plan, if any?

Answer in dollars, if any, and cents, if any, per share, or none.

ANSWER: $37.80

SPECIAL ISSUE NO. 6

Do you find from a preponderance of the evidence that on or about May 1969 Defendant Mize agreed that Southdown would give to Defendant Range, and that Range agreed to

accept, a qualified stock option on 25,000 shares of Southdown common stock in the event that Pearl was merged into Southdown?

Answer "yes" or "no" ANSWER: yes

If you have answered special issue no. 6 "yes", then answer special issue no. 7. Otherwise, do not answer special issue no. 7.

SPECIAL ISSUE NO. 7

Do you find from a preponderance of the evidence that the existence of an agreement to pay Defendant Range a 25,000 share stock option, if any, was not adequately disclosed in the proxy statement?

Answer "It was not adequately disclosed" or "It was adequately disclosed".

ANSWER: It was not adequately disclosed

If you have answered Special Issue No. 7 "It was not adequately disclosed, then answer Special Issue No. 8. Otherwise, do not answer Special Issue No. 8.

SPECIAL ISSUE NO. 8

Do you find from a preponderance of the evidence that the August 12, 1969 Pearl proxy statement Plaintiff's Exhibits omission to disclose the agreement to pay Defendant Range the 25,000 share stock option, if you have so found, was an omission of a material fact necessary in order to make the statements in said proxy statement not misleading?

Answer "It was an omission of a material fact" or "It was not an omission of a material fact"

ANSWER: It was not an omission of material fact

SPECIAL ISSUE NO. 9

Do you find from a preponderance of the evidence that Pearl's August 12, 1969 proxy statement failed to adequately disclose

that the Board of Directors of Pearl had the power to waive the condition of Pearl's obligation to consummate the merger by obtaining a firm commitment from a group of underwriters to purchase up to 45% of the Southdown preferred stock at a price of $45 per share for a period of 10 days following the effective date of the merger?

Answer "yes" or "no" ANSWER: no

If you have answered special issue no. 9 "yes", then answer special issue no. 10. Otherwise, do not answer special issue no. 10.

SPECIAL ISSUE NO. 10

Do you find from a preponderance of the evidence that the power to waive the underwriting commitment was a material fact necessary to be disclosed in order to make other statements in the August 12, 1969 proxy statement not misleading?

Answer "yes" or "no" ANSWER:

SPECIAL ISSUE NO. 11

Do you find from a preponderance of the evidence that the failure of Pearl's August 12, 1969 proxy statement to state that Aztec Oil and Gas Co. had made an offer for all of the Pearl stock, and that Aztec's offer had been recommended in preference to Southdown's offer by the financial analyst hired by Pearl was an omission to state a material fact necessary in order to make the statement, in said proxy statement not misleading?

Answer "It was an omission of a material fact" or "It was not an omission of a material fact"

ANSWER: It was not an omission of a material fact

SPECIAL ISSUE NO. 14

Do you find from a preponderance of the evidence that Plaintiff Smallwood relied on any misrepresentation of material facts in the Pearl proxy statement or on the omission of any material

facts, if any you have found, in making his decision to vote in favor of the Pearl-Southdown merger on September 9, 1969?

Answer "yes" or "no" ANSWER: yes

SPECIAL ISSUE NO. 15

Do you find from a preponderance of the evidence that the failure of the November 18, 1969 letter from Southdown to the Pearl shareholders to inform the Pearl shareholders that the December 2, 1969 date for tendering their stock was a change in the terms of the agreement and plan of merger was the omission of a material fact necessary in order to make statements therein not misleading?

Answer "It was the omission of a material fact" or "It was not the omission of a material fact"

ANSWER: It was, omission of material fact

SPECIAL ISSUE NO. 16

Do you find from a preponderance of the evidence that the failure of the November 18, 1969 letter from Southdown to the Pearl shareholders to inform them that the merger could be consummated without an underwriting agreement and without the period of 10 days after the merger in which to tender their shares was the omission of a material fact necessary in order to make the statements therein not misleading?

Answer "It was the omission of a material fact" or "It was not the omission of a material fact"

ANSWER: It was the omission of a material fact

SPECIAL ISSUE NO. 17

Do you find from a preponderance of the evidence that the failure of the November 18, 1969 letter from Southdown to the Pearl shareholders to inform the Pearl shareholders that a corporation with a substantial investment in Southdown could be substituted for the underwriter was the omission of a material

fact necessary in order to make the statements made therein not misleading?

Answer "It was the omission of a material fact" or "It was not the omission of a material fact"

ANSWER: It was the omission of a material fact

If you have answered any of special issues 15, 16, or 17 "It was the omission of a material fact", answer special issue no. 18. Otherwise, do not answer special issue no. 18.

SPECIAL ISSUE NO. 18

Do you find from a preponderance of the evidence that if the omissions inquired about in special issues 15, 16, and 17 had been disclosed in the November 18, letter, a reasonable Pearl shareholder would have tendered his Southdown shares for $45 per share?

Answer "yes" or "no"

ANSWER: yes

SPECIAL ISSUE NO. 19

Do you find from a preponderance of the evidence that any of the following acts was an act, practice or course of business which operated as a fraud or deceit upon the Pearl Shareholders in connection with the Pearl-Southdown merger?

(a) The offer, if any, to Defendant Range of a 25,000 stock option and the failure, if any, to disclose it

Answer "yes" or "no"

ANSWER: no

(b) The failure to inform the Pearl shareholders that the date for tender of their Southdown preferred stock had been changed from the date set out in the agreement and plan of merger of September 9, 1969

Answer "yes" or "no"

ANSWER: yes

(c) The failure to inform Pearl shareholders that the merger

could have been consummated without a firm commitment from a group of underwriters.

Answer "yes" or "no" ANSWER: yes

(d) The failure to inform Pearl shareholders that the merger could have been consummated without a tender period of 10 days following the effective date of the merger.

Answer "yes" or "no" ANSWER: yes

(e) The failure to inform Pearl shareholders of the merger offer by Aztec and of the recommendation favoring such offer made by Pearl's financial advisors

Answer "yes" or "no" ANSWER: no

(f) The failure to inform the Pearl shareholders that Zapata-Norness, the party substituted for the underwriters, had a substantial ownership interest in Southdown

Answer "yes" or "no" ANSWER: yes

SPECIAL ISSUE NO. 20

Do you find from a preponderance of the evidence that after September 9, 1969 and before December 30, 1969 one or more of the Defendants in this case entered into a conspiracy with the Defendant Southdown to cause Pearl to be merged into Southdown on different terms than the agreement and plan of merger approved by Pearl shareholders on September 9, 1969?

Answer "yes" or "no" ANSWER: yes

If you have answered special issue no. 20 "yes", then answer special issue no. 21. Otherwise, do not answer special issue no. 21.

SPECIAL ISSUE NO. 21

State the names, if any, you have found by a preponderance of the evidence, of those who were parties to the conspiracy, if any.

Answer by naming the conspirators.

ANSWER: Southdown Inc. and Pearl Brewing Co.

If you have answered special issue no. 20 "yes", then answer special issue no. 22. Otherwise, do not answer special issue no. 22.

SPECIAL ISSUE NO. 22

Do you find from a preponderance of the evidence that such conspiracy, if any, was a proximate cause of the merger of Pearl Brewing Company into Southdown on December 30, 1969?

Answer "yes" or "no" ANSWER: no

SPECIAL ISSUE NO. 23

What do you find from a preponderance of the evidence would have been the reasonable cash market value of a share of Pearl Brewing Company stock on December 30, 1969, or shortly thereafter, if the Pearl Board of Directors had abandoned the proposed merger with Southdown?

Answer in dollars, if any, and cents, if any, per share or none.

ANSWER: $21.80

SPECIAL ISSUE NO. 24

What do you find from a preponderance of the evidence was the reasonable cash market value of the Pearl Brewing Company common stock immediately prior to the merger into Southdown, Inc. on December 30, 1969?

Answer in dollars, if any, and cents, if any, per share, or none.

ANSWER: $45.00

You are the sole judges of the facts, of the credibility of the witnesses and of the weight and credit to be given to the testimony, but the law you are bound to receive from the Court as it is given you herein, and be governed thereby. Arguments of Counsel are not evidence, nor are they to be taken as correct

statements of the law, if contrary to that which is given you by the Court.

You are further instructed that while you are deliberating upon your answers to the special issues that have been submitted to you, you will not mention nor refer to, nor take into consideration any matter, fact or circumstance, other than the testimony that has been admitted before you, all of which I instruct you particularly to observe and obey.

You are further instructed that each special issue must be answered by an unanimous vote of the Jury.

You will retire to the jury room, select your own foreman and write your answers to the special issues in the blank space left after each special issue for that purpose. Your foreman will sign the form of verdict as it is shown below.

SARAH T. HUGHES
United States District Judge

VERDICT:

WE, the Jury, have answered the foregoing special issues as indicated above and herewith return the same into court as our verdict in this case.

H. E. MONTGOMERY
Foreman of the Jury

CERTIFICATE OF SERVICE

A TRUE AND CORRECT COPY OF THE FOREGOING HAS BEEN SENT TO ALL ATTORNEYS OF RECORD IN THE ABOVE NUMBERED AND STYLED CAUSE.

Robert Goodfriend

Supreme Court, U. S.
FILED
JUN 21 1974
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of The United States

OCTOBER TERM 1974

No. 73-1671

JOE L. SMALLWOOD,

Petitioner,

v.

PEARL BREWING COMPANY, SOUTHDOWN, INC., ZAPATA NORNESS, INC., ALBERT J. RANGE AND D. DOYLE MIZE,

Respondents.

BRIEF OF THE RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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IN THE

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PEARL BREWING COMPANY, SOUTHDOWN, INC., ZAPATA NORNESS, INC., ALBERT J. RANGE AND D. DOYLE MIZE,

Respondents.

BRIEF OF THE RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

STATEMENT OF JURISDICTION

The District Court's jurisdiction was invoked by Section 27 of the Securities Exchange Act of 1934 (15 U.S.C. §§78aa) and certain claims were retained under the doctrine of pendent jurisdiction (Third Amended Original Complaint, Rec. 153).

QUESTIONS PRESENTED

1. Whether Respondents are to be denied the protection of the Seventh Amendment on factual issues found by a jury in their favor, to wit: that the Proxy Statement of Pearl Brewing Company (Pearl) did not omit to state or fail to disclose adequately all material matters required to be stated or disclosed therein?

2. Whether there exists any conflict among the decisions of the United States Circuit Courts of Appeals on the essential elements required to establish liability in private damage actions under Sections 10(b) and 14(e) of the Securities Exchange Act of 1934 ("Exchange Act") and the rules promulgated thereunder?

3. Whether the Court of Appeals for the Fifth Circuit correctly applied the liability and materiality standards of Sections 10(b) and 14(e) and the rules promulgated thereunder?

4. Whether, if this Court grants Smallwood's petition, the interests of justice will require reconsideration of certain of Respondents' arguments, either not considered by the Fifth Circuit or rejected below, to wit:

   a. The November 18, 1969 mailing to Pearl shareholders was not a "tender offer" within the meaning of Sections 14(d) and (e) of the Exchange Act;

   b. Smallwood has no derivative standing to sue in this case;

   c. The waiver power was adequately disclosed as a matter of law; and

d. Range's potential conflict of interest was adequately disclosed as a matter of law?

STATEMENT

The story begins innocuously enough in the summer of 1968 with the commencement of a search by Pearl Brewing Company for a suitable merger partner.[1] Seeking further diversification, Pearl, a Texas corporation engaged in the manufacture of beer, soft drinks, and candy, rejected feelers from other firms in the consumer foods industry. Then, in the spring of 1969, three new merger candidates appeared — Aztec Oil & Gas Company, Infotech, and Southdown, Inc. Infotech was a start-up enterprise with no business history, and its merger offer was quickly dismissed. Aztec, a natural gas producer, offered a straight stock-for-stock exchange. Southdown, a Louisiana corporation with interests in sugar production, oil and gas, and real estate, originally offered to purchase a controlling interest in Pearl stock for cash.[2] After some preliminary negotiations, Southdown altered its proposal to provide the option of a stock-for-stock exchange in a tax-free merger.[3] The Aztec and Southdown proposals were referred to Duff, Anderson & Clark, Inc., a Chicago financing and consulting firm, for study.

---

[1] The underlying reasons for Pearl's search for a merger partner were (1) the increased competition national breweries exerted on regional breweries and (2) the illness of its chief executive, Otto Koehler.

[2] In August 1969 Southdown acquired Canal Assets, Inc., which was engaged in rice milling and irrigation, and owned land and mineral interests.

[3] Southdown's proposal was that "the present owners of the controlling interest in Pearl (i.e. holders of at least 45% of the outstanding Pearl stock) would enter into an agreement with [Southdown] to sell their stock for $45 per share in cash or, at their option, in exchange for Southdown's $1.80 Cumulative Convertible Preferred Stock in a tax-free merger".

On June 26, 1969, representatives of Duff, Anderson & Clark orally reported to the Pearl Board of Directors that in their opinion both proposals would benefit Pearl, but that the Aztec offer was slightly the better of the two because it had "more upside potential near term". When the Pearl Board met again on July 7, 1969, representatives of Aztec and Southdown appeared to present their proposals. After the presentations, one of Pearl's attorneys reported to the Board that El Paso Natural Gas Company, Aztec's chief customer, was under no obligation to continue purchasing gas from Aztec. The Pearl Board then informally indicated its approval of the Southdown proposal and instructed Pearl's attorneys to meet with Southdown's attorneys in an attempt to work out a merger agreement.

A merger agreement between Pearl and Southdown was approved by the Pearl Board on July 11, 1969. The agreement provided that Pearl would be merged into Southdown and that for each share of Pearl common stock owned a shareholder would receive one share of Southdown convertible preferred stock. Pearl's obligation to consummate the merger was subject to "the fulfillment (or waiver by Pearl in writing)" of certain conditions, the most important of which would permit Pearl shareholders to "sell out" at least 45 percent of their newly acquired Southdown preferred stock on consummation of the merger for $45 a share:

> "Southdown shall have procured a firm commitment from a group of underwriters (which commitment shall be satisfactory in form and substance to the Board of Directors of Pearl) by which such underwriters will agree, for a period of ten days following the Effective Date, to purchase from those stockholders who desire to sell the same, at a price of $45 net per share, up to 45 percent of the shares of Southdown Preferred Stock into which the shares of Pearl stock held by such stockholders on the

Effective Date will have been converted upon consummation of the merger."

The purpose of requiring Southdown to gain a firm underwriting commitment was to accomplish the sell-out provision of the plan without making the merger taxable to Pearl shareholders. Although Southdown was willing to buy up to 45 percent of Pearl's stock for cash, Pearl's attorneys were of the opinion that if Southdown paid cash in addition to securities the merger would lose its tax-free status under Section 354 of the Internal Revenue Code of 1954, and the exchange of shares in the merger would become a taxable event to Pearl shareholders. Jack Guenther, one of Pearl's attorneys, testified that in his negotiations with Southdown he obtained the Pearl Board's right to waive the underwriting commitment so that Southdown could not avoid the merger by failing to procure an underwriting commitment. The purpose of the waiver power was explained to the Board when the Board approved the merger agreement. There was no testimony that it was anticipated at that time that an underwriting commitment would not prove possible. To the contrary, Guenther had received confirmation from Lehman Brothers, an investment banker, that a firm commitment was feasible.

According to testimony in the record the provision that the underwriters would purchase "for a period of ten days following the Effective Date . . . from those stockholders who desire to sell" was intended to indicate when the underwriters would purchase, not when shareholders would tender their shares for sale. The testimony at trial was that permitting shareholders ten days after the merger to tender their shares for sale to underwriters would be inconsistent with underwriters' requirements that they know before purchase the number of shares they must market.

On July 17, 1969, Pearl advised its shareholders by mail of the proposed merger with Southdown. The letter indi-

cated that both the Pearl and the Southdown Boards of Directors believed the merger to be mutually beneficial and recommended shareholder approval. Enclosed with the letter was a copy of a press release describing the basic terms of the merger proposal and stating: "It is a condition to Pearl's obligation to consummate the merger that, on the effective date of the merger, Southdown shall have obtained an underwriting commitment affording the former Pearl stockholders the opportunity to sell, at $45.00 net per share, up to 45% of the Southdown preferred stock received by them in the merger." The power of the Pearl Board to waive the underwriting commitment was not mentioned.

Pearl management communicated again with the shareholders on August 12. The materials distributed that day included a cover letter, a notice of a special shareholders' meeting to be held on September 9, 1973, a proxy, and the proxy statement with appendices. The first sentence of the proxy statement referred the reader to the merger agreement between Pearl and Southdown and indicated that a copy of the agreement could be found attached as Appendix II. The agreement, of course, contained the conditions of Pearl's obligation to merge written in full, including the power of the Pearl Board to waive them.

The proxy statement revealed that Albert Range, Executive Vice President of Pearl, would be employed by Southdown under a five-year employment contract at $75,000 per annum and that Range would become a director of Southdown. Moreover, the proxy statement indicated, as a result of the merger Range's 2,620 shares of Pearl stock would be converted into an equal number of Southdown shares. Although during preliminary negotiations between Southdown and Pearl, D. Doyle Mize, the Chairman of Southdown's Board, had discussed a stock option of 25,000 shares with Range, the proxy materials did not disclose that fact.

On September 9, 1969, the shareholders voted 1,253,337 shares to 35,449 in favor of the merger. December 10, 1969, was tentatively set as the merger date.

To implement the sell-out provision of the merger agreement, Southdown mailed to the Pearl shareholders, on November 18, 1969, a cover letter, a draft of an underwriting agreement, a preliminary prospectus, and forms. The shareholders were informed that to sell their shares of Southdown preferred stock to the underwriters upon consummation of the merger they must tender their Pearl stock certificates, with the appropriate deposit forms, to be in the hands of designated exchange agents "prior to 3:30 p.m., EST, on December 2, 1969". By December 2 approximately 545,000 shares, about 58.5 percent of the outstanding Pearl stock, had been deposited.

Through the summer and into the fall of 1969 the price of Southdown common stock had run counter to a general downward trend in the securities market. Testimony indicated that Lehman Brothers had continued to believe, and communicated this belief to Pearl's attorneys and Southdown, that a syndicate of underwriters would purchase up to 45 percent of the Southdown preferred stock at $45 a share. Late in November, however, the price of Southdown common declined precipitously. Lehman Brothers communicated to Southdown that an underwriting for more than 250,000 shares would not be possible. After talking to Mize on December 3, Range wrote to 25 Pearl shareholders, each of whom owned 5,000 or more shares of Pearl stock. He requested that those addressees who had deposited more than 25 percent of their stock for sale reduce their deposit to 25 percent. In response to this request, the number of deposited shares was reduced to approximately 255,000. Negotiations continued between Southdown and Lehman Brothers, but as the price of Southdown common continued to drop, an underwriting for even 255,000 shares became increasingly doubtful. Southdown discussed with Lehman

Brothers indemnifying the underwriters for a loss of up to $1,000,000 on the resale of the Southdown preferred. Although Lehman Brothers tentatively agreed to this plan, the value of Southdown stock dropped to the point where Lehman Brothers considered that even $1,000,000 was insufficient.

While serious discussions were still continuing between Southdown and Lehman Brothers, on December 13 discussions began between Southdown and Zapata Norness, Inc., a controlling shareholder of Southdown. According to Mize's testimony, talks with Zapata were initiated on the assumption that if Southdown would pay $1,000,000 to obtain buyers for the 255,000 deposited shares, it should pay that amount to Zapata. The idea of paying Zapata $1,000,000 to purchase the shares of Southdown preferred was discarded when Southdown was advised by its attorneys that such a payment would cause the merger to be considered a taxable transaction. Nevertheless, discussions with Zapata continued, and Zapata agreed to purchase the deposited shares for $45 a share.

The merger agreement provided that it was terminable by either party unilaterally if the merger was not consummated by December 31. On December 22, 1969, the Board of Directors of Pearl met to consider the status of the merger plans. At the meeting, the Pearl Board voted to accept Zapata's offer and approved the consummation of the merger. On December 30, 1969, Southdown and Pearl merged. Zapata then purchased the deposited shares for $45 each.

At the trial below the jury found that immediately before the merger on December 30 Pearl common stock was worth $45 a share. Each share of Southdown preferred would have been worth $45 had the merger been consummated "in accordance with the terms and conditions set forth in the agreement and plan of merger". The jury found,

however, that on actual consummation of the merger each share of Southdown preferred was worth only $37.80. Still, the price of Pearl stock had risen from about $30 to over $40 during the summer and fall of 1969. Had the merger plans been abandoned, the jury found, Pearl stock would have plummeted to $21.80 per share.

SUMMARY OF REASONS FOR DENYING CERTIORARI

Petitioner asks this Court to substitute its factual review of the extensive record below for that of the jury who tried this case, the District Judge who presided over the trial of this case and three members of the Fifth Circuit Court of Appeals. The jury was not asked (on special issues) about the culpability of any one or more of the Respondents. The District Judge who presided over the trial of this case held:

> "The waiver by the Pearl Board of the condition in the merger plan to procure an underwriting commitment was not only expressly provided for but was a decision in which the Board exercised reasonable and prudent business judgment in order to facilitate the merger (App. 9)."

The Fifth Circuit opinion reasoned:

> "Far from reflecting a 'clear, persistent, and almost defiant disregard of the securities laws and the rights of Pearl's stockholders', the record in this case shows a corporation, caught in a downward-moving securities market, attempting to salvage what it could for its shareholders of a deal made in anticipation of less gloomy days (App. 70-71)."

This Court should not add a factual-review case to its docket.

Petitioner's next attack upon the judgments below is bottomed upon the legal proposition that legal liability in private damage actions under Sections 10(b) and 14(e) exists independent of culpability. Such proposition goes

counter to prevailing authority and is urged by petitioner without the support of authority.

Petitioner's last claim is that the District Court erred in its definition of *materiality* in its charge to the jury. The definition of materiality was, at a minimum, in accordance with prevailing authority and was more favorable to petitioner than the law accords in the Second Circuit.

REASONS FOR DENYING CERTIORARI

1. *The jury determined (i) that the power to waive receipt of the underwriting commitment was adequately disclosed and (ii) that the failure to disclose Range's stock option was not the omission of a material fact; and such determinations are supported by the evidence.* The issues arising under the proxy rules relate to (i) the adequacy of disclosure of the waiver, and (ii) the materiality of the omission to describe an offered stock option respecting Albert J. Range. Respondents' position is that both such issues should have been decided favorably to them as a matter of law. Nevertheless, the jury determined them favorably to Respondents. This Court should not grant ". . . certiorari to review evidence and discuss specific facts." *United States* v. *Johnston*, 268 U.S. 220, 227 (1924).

Petitioner continues to burden his printed briefs (Pet. 8, f.n. 5) with a plethora of cases which have affixed liability on defendants under different circumstances than exist in this case.[4]

The Petition also mistakes the holding of the Fifth Circuit, in refusing to override the jury finding on the waiver power (489 F.2d 579,602-3). That holding is *not*

[4] *Mills* v. *The Electric Auto-Lite Company*, 403 F.2d 429 (7th Cir. 1968), *aff'd* 396 U.S. 375 (1970), involved a failure to disclose a conflict of interest; *Swanson* v. *American Consumer Industries, Inc.*, 415 F.2d 1326 (7th Cir. 1969), involved a failure to disclose a conflict of interest; *Beatty* v. *Bright*, 318 F. Supp. 169 (S.D. Iowa 1970) involved a failure to disclose a conflict of interest;

to the effect that, as a matter of law, a discretionary waiver power need never be disclosed unless the occasion of its exercise is foreseen, or predictable. Rather, among the *reasons for refusing to overturn a jury verdict of adequate disclosures,* the Fifth Circuit cited a complete "lack of evidence that anyone should reasonably have anticipated that the waiver provision would be material to the shareholder's decision to approve or disapprove the merger" (*ibid.,* 603). There is no legal issue presented for review by the holding of the Court of Appeals. Petitioner was unable to obtain and introduce into evidence any facts from which a jury might have inferred *inadequate* disclosure. Indeed, petitioner himself testified at trial that he saw, read and understood the waiver language in the proxy material when he received it.

The "ten day" period to which petitioner adverts was a period related to the underwriting and during which the underwriters would pay for the stock they purchased. When the underwriting was waived, the "ten day" period became irrelevant. Contrary to petitioner's bold assertion, the jury *did not* find that petitioner had a ten-day period within which to tender his stock, and indeed Respondents objected to the Court's failure to submit such an issue.

2. *There exists no conflict among the Circuit Courts of Appeals on the standard of proof required to establish liability in cases under Rule 10b-5 and Section 14(e) of the Exchange Act.* The decisions of the Courts of Appeals, cited by the Petition, show no split or conflict among the Circuits on the evidentiary standards applied under Rule

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Gould v. *American Hawaiian Steamship Co.,* 331 F. Supp. 981 (D. Delaware 1971) involved a failure to disclose the different treatment accorded certain shareholders in a merger and *Kohn* v. *American Metal Climax, Inc.,* 332 F. Supp. 1331 (E.D. Pa. 1970) involved a fact finding by the Court in a non-jury case.

10b-5 and Section 14(e)[5]. Conflicts in the application of legal standards arise when cases which are otherwise indistinguishable (or closely analagous on the facts) are decided with conflicting results. The process of elaboration or development of the law of Rule 10b-5, through careful distinction between different sets of circumstances, does not contribute confusion or generate conflict in the results.

The Fifth Circuit correctly set forth the prevailing law on Rule 10b-5 and Section 14(e) liability in private damage actions:

> "Some culpability has consistently been required as an element of proof in this Circuit in cases alleging violations of Rule 10b–5. See, e. g., Herpich v. Wallace, 5 Cir. 1970, 430 F.2d 792, 804; Clement A. Evans & Co. v. McAlpine, 5 Cir. 1970, 434 F.2d 100, 103, cert. denied, 402 U.S. 988, 91 S.Ct. 1660, 29 L.Ed.2d 153. And we reiterate that the elements to be proved to establish a violation of Section 14(e) are identical to those under the Rule. There is no question of requiring plaintiffs to prove scienter in its strict common law sense — that the defendants made statements they either knew to be false or knew they had no basis for believing were true. See Derry v. Peel, House of Lords 1889, 14

[5] *Ellis* v. *Carter*, 291 F.2d 270 (9th Cir. 1961) contains *dicta* to the effect that *scienter* is not required in actions under Sections 11, 12(1) and 12(2) of the *Securities Act of 1933* (which is not here in issue), but as to Rule 10b-5 holds on the narrow question of the sufficiency of the pleadings to withstand summary judgment and state a claim for private recovery. *Kohler* v. *Kohler*, 319 F.2d 634 (7th Cir. 1963) held that an accountant, retained to negotiate a stock sale, did not breach a fiduciary duty in failing to volunteer certain accounting details affecting the company; and the court noted in passing that 10b-5 did not require proof of *deliberate* dishonesty (which is, similarly, not in issue here). *Myzel* v. *Fields*, 386 F.2d 718 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968) merely affirmed the trial court's action in overruling motion for new trial and judgment n.o.v. following full trial to a jury in which the trial court's instructions required scienter. *Stevens* v. *Vowell*, 343 F.2d 374 (10th Cir. 1965), involved a challenge to subject-matter jurisdiction. The appellate court refused to override the findings of fact by the trial court. The issue of scienter or culpability beyond mere negligence was not considered.

App. Cas. 337, 374. The trend in the federal courts has been toward a more relaxed test. See, e. g., Stevens v. Vowell, 10 Cir. 1965, 343 F.2d 374, 379 (common law fraud not required); S. E. C. v. Texas Gulf Sulphur Co., 2 Cir. 1968, 401 F.2d 833, 854 (en banc), cert. denied, sub nom., Coates v. S. E. C. & S. E. C. v. Kline, 394 U.S. 976, 89 S.Ct. 1454, 22 L.Ed.2d 756 (specific intent to defraud not required); City National Bank v. Vanderboom, 8 Cir. 1970, 422 F.2d 221, 229, cert. denied, 399 U.S. 905, 90 S.Ct. 2196, 26 L.Ed.2d 560 (knowledge of impression made not required); Kohler v. Kohler Co., 7 Cir. 1963, 319 F.2d 634, 637 (knowledge of falsity and bad faith intent to mislead not required). Some Courts have gone so far as to state, or hint, that they were abandoning the fraud requirement under Rule 10b-5. Nevertheless, liability in a private action for damages has apparently never been imposed for negligent conduct under the Rule. See Bucklo, Scienter and Rule 10b-5, 67 Nw.U.L.Rev. 562. With scienter requirements in a state of flux in the Courts of Appeals, we do not view this as the proper occasion to draw the bottom line on the degree of scienter required in this Circuit. Suffice it to say that some culpability, beyond mere negligence, is required (App. 66-67)."

In *Mitchell* v. *Texas Gulf Sulphur Company*, 446 F.2d 90, 102 (10th Cir. 1971) the case was tried to the court, which found that the defendants "knew the press release statements were incorrect and misleading, and knew or should have known that the statements would be relied upon by shareholders." Quoting the Second Circuit with approval, the Tenth Circuit continued that it "seems clear" that if corporate management was diligent and disseminated information "in good faith," Rule 10b-5 would not have been violated.[6] That case, involving insider trading, is not "in conflict with" *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F.2d 1281 (2d Cir. 1973), which was an action under Section 14(a) of the Exchange Act involving violations of the proxy

[6] Compare Pet., p. 12, text and fn. 10.

rules.[7] In *White* v. *Abrams*, CCH Fed. Sec. L. Rep. ¶94,457 (9th Cir., 1974) (Current Volume) the court reversed and remanded a judgment for the plaintiff, on a jury instruction that purported to impose 10b-5 liability for misstatements or omissions, even though made in good faith and in a non-negligent manner, stating:

> "The court's instruction would impose upon Abrams a duty to insure the truthfullness and reliability of the representations he has made. We reject such a broad construction since there is no indication that Congress in passing Section 10(b) of the Securities Exchange Act of 1934, or the Securities and Exchange Commission, in issuing Rule 10b-5 thereunder, intended that anyone should be an insurer against false or misleading statements made non-negligently or in good faith. *Kohn* v. *American Metal Climax, Inc.*, 458 F.2d 255, 280. See *List* v. *Fashion Park*, 340 F.2d 457, 463 (2d Cir.), *cert. denied*, 382 U.S. 811(1965)."

The *White* v. *Abrams* court offered a tentative set of guidelines, tailored to the facts of that case, which bear no relation to the fact at issue here. That decision cannot possibly be construed as an outright rejection of the broad "culpability" standard, adverted to by the Second Circuit in *Chris-Craft Industries, Inc.* v. *Bangor Punta*, 480 F.2d 341, 363 (2d Cir. 1973), and applied by the Fifth Circuit in this case.

Far from indicating conflict and confusion among the Circuits, in the application of standards of liability under Sections 10(b) and 14(e), the cases cited show a consistent regard for the judgment of the trier of fact, and a persis-

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[7] See also in this regard, *Kohn* v. *American Metal Climax, Inc.*, 458 F.2d 255, 288 (3d Cir. 1971) *cert. denied*, 409 U.S. 874 (1971), cited by petitioner and involving the proxy solicitation ancillary to a merger, also tried to the district court: "In view of . . . the fact that fraud or culpability appears to be the lynchpin of Section 10(b) and the regulation thereunder, it is critical that the elements of fraud *vel non* not be predicated on mere conclusory statements."

tent requirement of "something more than mere negligence."[8]

3. *The Court of Appeals for the Fifth Circuit correctly applied the liability and materiality standards of Sections 10(b) and 14(e), and of Rule 10b-5.* The petitioner failed to obtain any of the findings of fact that would establish liability under Sections 10(b) and 14(e) or Rule 10b-5. He obtained no finding that the Merger Agreement offered (or could reasonably be construed to offer) Pearl shareholders a 10-day period following the merger to "put" or tender shares of their preferred stock directly to the underwriters. He requested no issue relating to such a finding. There is undisputed evidence in the record that the Merge. Agreement did not offer a "10-day put" following the merger. The petitioner's Special Issues Nos. 1-3 (Pet. A-78, 79) assume the elimination of a "10-day put," were therefore misleading, and were predicated on mere unsubstantiated conclusions of the petitioner. Similarly, Special Issues Nos. 15-17, on which petitioner relies heavily (Pet. 5, App. 82), assume conclusions of fact or law, and do not relate back to the proxy statement and the disclosures made in the proxy solicitation of which petitioner now claims the November 18 mailing was "an integral part".

Petitioner cannot have it both ways. There is no doubt, as the District Court held, that if the November 18 mailing is regarded separately, it could not have caused any Pearl shareholder not to deposit his stock for sale. No Pearl shareholder appeared in court to testify that he was misled by the November 18 mailing and petitioner has obtained no finding of bad faith or culpability. On the other hand, if the

[8] Petitioner argues that the Fifth Circuit acknowledges that four Circuits have stated or implied that there is no scienter or culpability requirement under Rule 10b-5 (Pet. 12), but the Court's opinion goes further than petitioner suggests:

> "Nevertheless, liability in a private action for damages has apparently never been imposed for negligent conduct under the Rule (App. 67)."

November 18 mailing is regarded as "an *integral part*" of the proxy solicitation, the Court of Appeals is surely correct: petitioner has obtained no finding of "elimination of a 10-day put" upon which to predicate the findings he relies on. Those assertions do not rest on any evidence in the record.

The Appeals Court dealt with the definition of materiality and correctly concluded that petitioner obtained a more favorable definition than that to which he was entitled.

There is no authority supporting Smallwood's attack on the District Court's charge to the jury regarding materiality. In *Clement A. Evans & Co., Inc.* v. *McAlpine,* 434 F.2d 100, 103 (5th Cir. 1970), *cert. denied* 402 U.S. 988 (1971), it was held that the proper standard of materiality was as follows:

> "With regard to nondisclosures, the issue becomes whether a reasonable investor, in light of the facts existing at the time of the nondisclosure and in the exercise of due care, would have been entitled to receive full disclosure from the party charged *and would have acted differently had the alleged non-disclosure not occurred.*" (*Citing City National Bank of Fort Smith, Ark.* v. *Vanderboom,* 422 F.2d 221 (8th Cir. 1970), *cert. denied* 399 U.S. 905; *Heit* v. *Weitzen,* 402 F.2d 909 (2nd Cir. 1968), *cert. denied,* 395 U.S. 903 (1969); *S.E.C.* v. *Texas Gulf Sulphur Co.,* 401 F.2d 833 at 863; emphasis supplied).

More recently, in *John R. Lewis Inc.* v. *Newman,* 446 F.2d 800 (5th Cir., 1971), it was again held, in the context of an action under Section 10(b) and Rule 10b-5, that the conventional test for materiality is "whether a reasonable man *would attach importance* to the fact misrepresented in determining his course of action in the transaction in question." (At 804 citing *List* v. *Fashion Park, Inc.,* 340 F.2d 457, 462 (2nd Cir. 1965), *cert. denied* 382 U.S. 811, 86 S. Ct.

23; *Gilbert* v. *Nixon*, 429 F.2d 348, 355-56 (10 Cir. 1970) and cases cited therein). *Mills* v. *Electric Auto-Lite, supra*, upon which Smallwood relies, adverted to the "would" standard of *List* v. *Fashion Park*, holding that adequate disclosure "would have warned the stockholders to give more careful scrutiny to the terms of the merger," which the disclosure of Range's salary and proposed accession to the Southdown board did here. *Mills* states that a defect in proxy solicitation, to be material must have "a significant *propensity* to affect the voting process" and that "a cause of action cannot be established by proof of a defect so trivial, so unrelated to the transaction for which approval is sought, that correction of the defect or imposition of liability would not further the interest protected by § 14(a)." 396 U.S. 375 at 384. It is interesting that in the *Mills* case, which was not a case involving a construction of the court's charge to the jury, the Supreme Court cited *List* and *General Time Corp.* v. *Talley Industries, Inc.*, 403 F.2d 159, 162 (2d Cir. 1968).

In *Talley*, the Second Circuit stated:

> "The test, we suppose, is whether, taking a properly realistic view, there is a substantial likelihood that the misstatement or omission may have led a stockholder to grant a proxy to the solicitor or to withhold one from the other side, whereas in the absence of this he would have taken a contrary course (at page 162)."

The District Court in the instant case refused Respondents' requested instruction on materiality, which would have included the *Talley* requirement that an omission be of such significance that it would have caused the shareholder to take action different from that which he did take. The petitioner obtained a more favorable definition of materiality than that to which the law entitles him.

4. *If this Court grants Smallwood's Petition, the interests of justice will require a reconsideration of certain of Respondents' arguments not considered by the Fifth Circuit or rejected below.*

The petition assumes throughout (i) that the November 18 mailing was a "tender offer" and (ii) that Smallwood has standing to sue derivatively on behalf of Pearl. Should the Court grant the petition, the interests of substantial justice would be served only if Respondents can obtain reconsideration of such issues. *Langes* v. *Green*, 282 U.S. 531, 535-539 (1931); and see *Mills* v. *Electric Auto-Lite, supra* at 381, n.4, and comments of Stern, 87 *Harv. L.Rev.* 763, at 774 (1974).

a. *The November 18 mailing was not a "tender offer".* The merger of Pearl into Southdown would have occurred if all Pearl shareholders had elected to retain 100% of the preferred stock issued in the merger. The November 18 mailing was not a "request" or "solicitation", and does not fall into the category of "tender offer" or "invitation for tenders" which the Williams Act sought to regulate. The November 18 mailing was the mechanical means whereby Pearl shareholders would evidence their choice of the cash sale feature of the merger.[9] "Southdown clearly did not seek to acquire control of Pearl through a cash tender offer, hostile or otherwise" (Pet. A-13). A tender offer must at least have "terms" which are being "offered." The November 18 mailing merely advised Pearl shareholders of the *procedures* by which they could evidence their choice under the terms of the Merger Agreement, as previously approved by Pearl shareholders.

b. *Petitioner has no derivative standing to sue in this case.* There is no testimony in this case that any Pearl

[9] The first sentence of the Covering Letter refers the reader to the Merger Agreement pursuant to which the letter and enclosures are being sent (Ex. Vol. 109).

shareholder failed to deposit his Preferred Stock for sale to Zapata in reliance on a "10-day put." The special issues, relied on by petitioner and relating to the November 18 mailing are derivative issues. Smallwood has no standing to sue derivatively on behalf of Pearl. See *Landy* v. *Federal Deposit Insurance Corporation,* CCH Fed. Sec. L. Reg., ¶94,094 (3d Cir.) (1973 Trans. Bind.) The present case, unlike *Superintendent of Insurance* v. *Bankers Life and Casualty Co.*, 404 U.S. 6 (1971) involved no injury to Pearl.

c. *The waiver power was adequately disclosed as a matter of law.*

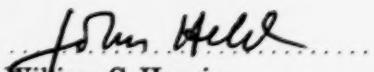
d. *Range's potential conflict of interest was adequately disclosed as a matter of law.*

The waiver power was adequately disclosed as well as was Range's potential conflict of interest. Issues inquiring about the adequate disclosure of those matters should not have been submitted to the jury, but rather should have been determined by the District Court, as a matter of law, to have been adequately disclosed. *Laurenzano* v. *Einbender,* 448 F.2d 1 (2d Cir. 1971). Furthermore, the statutes regarding disclosure in proxy materials require the absence of false and misleading statements and require affirmative disclosure of matters which, in light of matters stated, are needed to be said in order to make matters stated not misleading. Neither the statutes nor rules of the Commission require corporate reorganizations and mergers to be explained in language comprehensible to school children. *Shvetz* v. *Industrial Rayon Corp.,* 212 F. Supp. 308 (S.D.N.Y. 1960).

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,



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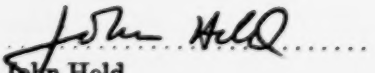
CERTIFICATE OF SERVICE

I certify that on this the 20th day of June, 1974, I mailed, certified mail, return receipt requested, two copies of Respondents' brief to Mr. John L. Hauer, Republic Bank Tower, Dallas, Texas 75201.



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